FINANCIAL PLANNING AND INVESTMENTS FOR MILITARY PERSONNEL

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NAVAL POSTGRADUATE SCHOOL
Monterey, California

THESIS

FINANCIAL PLANNING AND INVESTMENTS
FOR MILITARY PERSONNEL

by

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Financial Planning and Investments
For
Military Personnel

by

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Lieutenant Commander, United States Navy
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Submitted in partial fulfillment of the
requirements for the degree of

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ABSTRACT

The study discusses the financial problems of the general populace, and how those people in the military experience many of those same problems in spite of the considerable benefits they receive. An attempt is made to increase awareness of these problems by a discussion of how and why those in the military often mismanage their financial affairs. The thesis focuses on two common difficulties which often confront service families. In addition, it concentrates on the setting of financial goals and methods of achieving them so that income resources may be more effectively employed and personal financial difficulties averted.

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INTRODUCTION

In spite of having substantial incomes and fringe benefits, military personnel have a tendency to poorly manage their personal resources. Thus, while considerable funds come under their control during their lifetime, service families often find themselves unable or inadequately prepared to carry out certain financial responsibilities. Some do manage their personal affairs wisely, but the majority fail to anticipate the burden of the financial responsibilities which they must eventually bear. Their financial well-being is far less than would be expected from the resource potential at their command.

This wastage of potential is often caused by attitudes and concepts about finances that are acquired in military life. With the advantages of good income combined with exceptional job security, it is difficult for the serviceman to realize the full extent of his future responsibilities. He tends to postpone or disregard planning, and where planning is accomplished it is likely to be of an ultra-conservative nature. Thus, even when planning is done the amount of capital accumulated may be insufficient. Two major responsibilities, providing a house and providing educational funds, are many times coincident with the usual time of retirement which is when the serviceman's financial position may be somewhat vunerable. At 20 years of service the retirement pay is less than half of the active-duty income, and there

are also psychological factors that come into play in the adjustment to civilian life. Relatively large amounts of capital are required to carry out these responsibilities, and this requirement occurs at the same time that the new retiree may be most unsettled. The individual who has consistently saved and earned a high effective return on his investments through a well-conceived plan is best prepared to meet these responsibilities. Those less prepared may be able to finance these heavy expenditures, but it is often at the expense of all capital that has been accumulated. If the planning is grossly inadequate, footing the bill for these two expenses alone may require a large portion of all income.

OBJECTIVE OF THESIS

The objective of this thesis is to help the reader commit in the most effective manner possible those personal resources which come under his control during his earning life. This primary objective will be addressed by organizing material in such a manner as to treat the following subordinate objectives.

1. To increase the reader's insight and awareness of the problems.

2. How the serviceman can best manage and control the resources at his disposal so that increased savings may be accomplished. An effort has been made to provide the reader with enough information so that he can make rational decisions and prudent judgements about his personal affairs.

3. To assist the reader in setting his own financial goals, and to develop a knowledge of the necessary principles for committing these resources to produce the maximum benefit. Throughout the thesis an attempt is made to bring about a change in attitudes and concepts about personal finances because it is the opinion of the author that one's personal financial successes are highly dependent on his philosophy of life.

It is not the intent of this thesis to elaborate on such subjects as investments, insurance, tax-shelters, and savings except for the purposes of practical demonstration because much more authoritative and detailed information is available in each of the subject areas. Neither are exact recommendations made as to what particular investments programs one should undertake because this is largely dependent on individual circumstances and personalities. An effort is made to develop interest in the types of investments that are more lucrative and advantageous and to demonstrate the effects of inflation, the time value of money, dollar-cost averaging, leverage, long-term capital gains, tax-shelters, principles of ownership, and rates of return on investments.

The thesis is generally related to the officer community, and the goals of officers are primarily considered. However, others can apply the same principles in their planning. The thesis is primarily focused on the critical time in the serviceman's career when he has about 20 years of service. It is also directed at younger officers who may have failed

to make early plans for their futures, in an attempt to bring about self appraisal and to encourage and stimulate interest in this important, but often neglected area.

I. THE EXTENT OF PERSONAL FINANCIAL DIFFICULTIES IN THE UNITED STATES

STATUS OF ESTATES

It is somewhat disconcerting that in a nation so rich as the United States and where such high personal incomes are earned, that so few accumulate more than rather modest amounts of capital or ever attain a position of financial independence in retirement.

The overall wealth of the United States constitutes a goodly proportion of the wealth of the world. As a nation we make up a small percentage of the world's population, yet we consume a large share of the world's goods. Oddly enough, for all the wealth we enjoy as a nation, we are poor as individuals. As a rule our personal finances are in a state of shambles and a vast majority of Americans are reduced to seeking out an existence, living from paycheck to paycheck, although they are receiving high incomes.

> Most Americans- citizens of the wealthiest, most powerful and most ideal swathed country in the world - by a very wide margin own nothing more than their household goods, a few glittering gadgets such as automobiles and television sets (usually purchased on the installment plan,---) and the clothes on their backs /Lundberg, p. 11_7.

STATUS OF ESTATES

Several involved and thorough studies have been conducted into the nature of and the reasons for the deplorable conditions of Americans' personal finances. Perhaps one of the most

notable was that conducted by Professor Robert J. Lampman from 1947 through 1963 which was published by the Princeton University Press in 1962. Although his findings were primarily based on data taken through 1953, current observations tend to indicate that conditions prevailing 20 years ago still hold true. Knowing that it is extremely difficult to arrive at peoples' wealth or incomes, Professor Lampman conducted his study based on federal estate tax returns. He established that the mean gross estate was $3,500 and the average was $10,800; and that over 50% of the people in the United States had gross estates of less than $1,800, the next 18.4% had gross estates on the average of $6,000, and the next 21.89% had on the average of $15,000. This data was consistent with a separately conducted University of Michigan study which derived the data by other methods [Lundberg, p. 17]. Keeping in mind that gross estate was measured, not net estate, Professor Lundberg, the author of THE RICH AND THE SUPER RICH, goes on to say that these percentages bring into view about 92.5% of the people who do not yet have enough capital even to cover a serious family illness.

On the other side of the coin he found that 1.6% of the adult population owned more than 30% of all the assets and equities of the private sector of the economy. The same 1.6% owned 82.2% of the stock, 100% of the municipal bonds, 38.2% of the federal bonds, 88.5% of the corporate bonds, 29.1% of the cash, and 36.2% of the notes and mortgages of the country. The same small percentage, no doubt, gets a

lion's share of the personal income of the country and virtually control the country with their powerful influences in the economy and government. Even more appalling is that it is the upper quarter of this 1.6% that has most of the real wealth. Studies show that the concentration of net prime wealth in the hands of a few individuals has generally intensified over the years. Within the select 1.6% group, over half had less than $125,000 in gross estate and less than 2% of the select group (27,000 persons) had estates of more than $1,000,000 in 1953. Considering the stock market alone, several indexes quadrupled between 1950 and 1965 which would have advanced the position of the top wealth holders tremendously. During the same period the number of millionaires tripled to about 90,000, but the growth rate was far short of that in terms of 1950 prices /Lundberg, p. 18/. Recognizing that there is a great deal of fancy footwork involved in filing income tax returns; there were, however, only 28,000 individual income tax returns filed with adjusted gross incomes of $100,000 or more in 1959 /Miller, p. 6/. In poverty-ridden India, often the subject of our editorials concerning the very poor, about 1% of the population gets 50% of all income /Lundberg, p. 29/. None will question that the average Americans' standard of living is much higher than the average Indians', but obviously by the standard of ownership or real prime wealth the American is little better off than the Indian or our conception of the Russian peasant. Perhaps the only primary difference is that they have little choice in their state of affairs; the American falls into

his plight because of his own mismanagement and lack of financial individualism amidst boundless opportunity.

CONDITIONS OF THE AGED

As Americans, we enjoy the highest possible standards of living during our productive years. Most of us are successful in our professional lives or businesses, earn good incomes, and most enjoy some degree of affluency. But something rather tragic happens to most of us between the peak of our working years and the time we reach the years of full retirement. If the present generation continues in the traditions of the past, then only about 4 out of 100 will be financially independent in their retirement years. Statistics show that only 3% of all Americans have left gross estates in excess of $60,000 [Lundberg, p. 17]. Thus, while we may have acquired some wealth during our lifetimes, some 97% are unable to completely retain possessions including life insurance, equity in home, automobiles, and all personal articles and valuables, an amount equivalent to $60,000. Indeed, the gross estates of many do not even approach this sum and countless millions of Americans live out their old age in impoverished conditions.

The final result of our financial indiscretion and stupidity during our high income-producing years is tragic. In 1960 60% of all persons over age 65 existed on annual incomes of less than $1,000; another 20% lived on less than $2,000 [Troelstrup, p. 346]. A more recent study of the Social Security Administration in 1968 revealed that the median

income of all the aged receiving Old-Age, Survivors, Disability, and Health Insurance (OASDHI) benefits was $1,904 annually in 1967, and the median income of the non-beneficiaries was $1,490. Some 3% of the non-beneficiaries earned over $10,000 per year and 15% earned in excess of $5,000, but the median of the non-beneficiaries is low because of the majority earning low incomes. This was primarily caused by women being left without husbands; over half of all widows had incomes of $1,000 or less. Employment is a very important factor in the incomes of all the aged, and it is also an important factor in the incomes of the 3% of the non-beneficiaries who earned over $10,000 annually. Forty percent of the beneficiary couples had members in the labor force and over half of all the aged worked. The vast majority of those with no benefits had jobs. Earnings from employment provided 30% of the income of all the aged and the one out of 100 who made $15,000 annually obtained 49% of his income from employment. Some 90% of all the aged received OASDHI basic benefits and over half of those receiving benefits had less than $150 annually from all other sources including assistance from other family members [Merican, p. 3-23].

Often too much reliance can be placed in statistics. There is little doubt that many of the actual incomes of the aged are higher from earnings from odd-jobs, baby sitting and the like, which is never reported. But the study does point up an important fact. It shows that employment and benefits make up a large portion of the income of all the aged and

that the vast majority has no capital or assets. There are also indications that the aged have counted on these benefits almost exclusively for their support in their retirement.

BURDEN ON THE ECONOMY

The basic cause of all the misery of the aged is their own lack of planning and foresight, but placing the blame does not diminish the problem. These conditions have resulted in a heavy dependence on Social Security payments and have caused a heavy economic drain on the country. By and large the government is attentive and sympathetic to the problems of the aged, however the financial burden of supporting them at anything more than the minimum level of subsistence is overwhelming. Money that must be channeled into the welfare programs represents a substantial loss in productive capacity because nothing is returned for the value given. More importantly, perhaps, the average American has relinquished his basic rights of independence and individualism by his ever-increasing dependence on a socialistic form of government. While this is enough of a problem in itself, personal finances are the root of a number of our other social ills including marital difficulties, health, alcoholism, mental illness, and crime rates [Troelstrap, p. 63; Ferman, p. 28; Meissner, p. 43-69; Humphrey, p. 10-47].

Obviously the amount of benefits are insufficient although there have been substantial increases since the time the study was conducted. Most all of these aged have contributed

portions of their incomes for the benefits returned in retirement; but, the benefits are more or less fixed incomes which lag considerably behind the movement of major economic variables in the economy. The aged have some rights to enjoy a happy retirement and the country has a moral obligation to the aged, but the cold hard truth is that they don't get enough income and that the nation can ill afford to improve their conditions. The costs are already exhorbitant and burdensome to the present wage-earners and taxpayers. As a nation, we often take pride in the fact that our personal income tax rates are lower than most other industrialized countries, and it would seem feasible to increase the rates to provide a better livelihood for the elderly. What may not be realized however, is that a substantial part of the revenues collected by the government come from corporate taxes. The burden of this tax, along with many other "hidden" taxes, is ultimately passed to the public and the consumer. In reality the consumer foots the bill for any increases in corporate taxes according to his relative consumption, so the individual taxpayer cannot escape the burden of welfare programs. It is inevitable that he will pay the bill, by whatever name the tax is called. The country plunges recklessly onward knowing that Social Security will be an ever-increasing burden on the taxpayer.

INDICATIONS THAT THERE HAVE BEEN NO IMPROVEMENTS IN CONDITIONS

If the present working generations could but learn from the misfortunes of our aged, they might avoid similar situations in their futures. An effective and viable educational process

in personal finances accompanied with the threat of reducing benefits in the future might be enough to shock the average American out of his apathy and produce a significant savings to this country in terms of human misery, dollars, and lost productive capacity. However, this would not resolve the immediate problem. Whatever attempts that may have already been made to educate the public have been unsuccessful, and there is evidence to support that what Professor Lampman found in 1953 is true today, at least on a relative scale.

Some indicators are that consumer debt increased by 25 billion in 1973 /"U.S. Families Owe Too Much Money," 20 April, 1974_7. Between 1971 and the end of 1973 individual debt in the United States increased by 27% to the awesome figure of $810 billion /"Americans' Debts Rise," 18 April, 1974_7. This public demand for money obviously had a tremendous effect in rising interest rates during the 1973 and 1974 time period. Based on these figures alone, it would seem that the aggregate conditions and financial acumen of the public is no better in present times than in 1953.

Other facts point out the fact that the American lives above his means on consumer credit, and show that there is a great deal of waste in his income budgeting. During a period of inflationary prices and rising unemployment in 1974, the American has demonstrated an ability to tighten his belt and revise his buying habits. It took some time to pay off some of his previously contracted debts, but starting in October 1974,

outstanding consumer credit has dropped significantly each month with a record reduction of 877 million dollars in December /"Consumer Credit Outstanding Fell Again in January," 10 March, 1975/. This is not necessarily any indication that the American consumer is getting any smarter, but perhaps this does indicate that the American has a tendency to spend whatever his income and creditors will allow. We spend indiscriminately while resorting to day to day money planning based on hopes of ever-increasing incomes. The American will not revise his spending habits until conditions force him to do so. It is unfortunate that an economic downturn is required to bring this about, but there is little doubt that the American will return to his previous habits as soon as the economy affords him the opportunity.

If we continue, as does the vast majority, to spend 30% of our income on shelter, 20% on food, 20% for transportation, and 20% for installment debts /Neal, p. 103/ we might well conclude that our generation will be no better off in retirement than the aged of today, since only 10% of our income is left to pay taxes, insurance, clothing, savings, recreation and the like. Surely such living can only result in poverty and surely the immigrant who might view this as the land of "milk and honey" must have difficulty in understanding these conditions. Yet the immigrant can often arrive in this country penniless and within a few years accumulate a reasonable amount of capital. In most cases the immigrant has the edge on the American because he has goals, has hopes for the

future, and has a set of values and priorities. He has a much better opportunity of attaining financial security because of his resourcefulness and individualism, and following generations can normally hold onto this wealth for some time or at least until they have become educated in the "American Way."

II. BASIC CAUSES OF AMERICANS'FINANCIAL PROBLEMS

FAILURE TO PLAN

A large portion of our daily routine is dedicated to some form of earning money to provide for the necessities of life. However, as much time as we spend in the pursuit of money to provide for our basic needs and to improve our standards of living; little time, if any, is spent in planning for our future financial security.

> Planning is an integral part of the American genius. In government, business, and private social organizations our progress has been outstanding. On the other hand, individual financial planning has been largely neglected in our educational scheme. Yet it lies at the heart of our well-advertised goals of individual security, welfare, and happiness to say nothing of an enjoyable old age [Leibenderfer, p. 3].

Much of the discontent and distress in this country is brought about by our own lack of financial planning and reasoning which causes our personal difficulties. Whatever misfortunes may befall us, it is usually the result of our own neglect. Marriage counselors find that the major cause of marital difficulties develops because of a conflict in attitudes about money than from the amount of income itself. Often couples who have been having marital difficulties for years arrive at the counselors without even being aware that finances are the basis of the problem. Of those that do have some awareness that finances might be the root of the problem most either cannot or will not discuss the financial problem

with the spouse [Troelstrap, p. 63]. Certainly few plans can be made if there is no uniform understanding of common goals or if one party does not know the amount of income, debts insurance, and other obligations. What was determined from these studies of marital problems was that the amount of income had little bearing on the degree of happiness in a marriage. It was determined that happiness related to the amount of security the family had or thought it had. Those families with savings of $600 were relatively more happy than those with less savings, and there was a marked difference in the marital happiness when a family was indebted less than $300 in comparison with those more in debt [Troelstrap, p. 65]. Such sums are small indeed considering the enormous amounts of income that passes through our hands during our lifetimes.

People with better than average incomes often have financial problems for the same reasons. In a study made of the residents in the wealthier suburbs of New York several years ago where men were earning from $12,000 to $30,000, it was found that the average family was spending a great deal more than it was earning [Troelstrap, p. 56]. It follows that people with these extravagant spending habits are enjoying high standards of living, but obviously no future financial security is being provided. Such a family has some realization that it will lack the necessary resources for financing the childrens' education or for providing a retirement income, but cannot force itself to make the necessary adjustments to its "life style."

In modern times, few people are able to accumulate and retain wealth through their own skills and resourcefulness. Indeed, most of the existing fortunes have not been amassed by enterprising individuals in recent years, but are passed from generation to generation through inheritances and estates. This is perhaps demonstrated by the fact that 40% of the 1.6% of the group of top wealth holders in the United States are women who gained their estates primarily from the proceeds of life insurance policies /Lundberg, p. 29/. That few acquire and retain wealth by their own handiwork is also reflected by the general level of poverty of the aged. This clearly points out that few have the foresight and ability to retain a sizable portion of the money that passes through their hands. In cases where there may be a small amount of savings, this amount is often consumed by unforeseen expenses such as education, medical, and the expense of a retirement home which often fall in the later years of life. There may be many reasons why the American family enters their later years without adequate capital and heavily dependent on what is doled out to it, but inadequate financial planning is the basic cause.

The neglect of planning financially is not confined to any particular groups or sets of people. It is widespread. The alarming truth is that the difficulties don't apply just to a few families or in isolated areas; it is a national problem on a grand scale.

In many instances people may know what should be done, but simply will not make and carry out the necessary planning. Most realize, for example, the significance of estate planning in the event of death. The amount of estate taxes payable can vary by a wide margin dependent on the way an estate is set up, and many other complications that confront survivors could easily be avoided. Surveys show that 83% of those in moderate to high income brackets have thought about this type of planning. However, of those in the $10-$15,000 income bracket, only 8% had effected any changes. Of those making over $75,000 annually, only 16% had made changes. Only 35% of those with incomes over $300,000 had actually made changes to their plans [Springer, p. 178]. In such cases there is a great deal of effort put into the annual income tax return to save a few dollars, yet little effort at all has been applied in the direction that might save thousands in estate taxes, although there may be perfectly legitimate means of accomplishing this. There are numerous cases where the survivors of relatively well-to-do individuals have faced undue hardships and have been forced to give up excessive portions of their estates because of the manner in which they were configured. In certain situations planning can make the difference between the survivors having to struggle or being able to continue their lives free from financial worries.

Still another cause of our problems is that we don't always do what we think financially best. In a recent Opinion Research Corporation poll individuals were questioned as to

what investments offered the best opportunity to make money. Forty per cent indicated real estate and 14% indicated savings accounts. When further questioned as to their actual undertakings, the responses were almost the exact opposite; 14% were investing in real estate and 59% were investing in savings accounts ["Inflation: You are Losing your Assets," p. 35, 1 April, 1974].

SPENDING HABITS AND LACK OF THRIFT

It is generally acknowledged that "keeping up with the Joneses" is one of our basic flaws. Although we feel important responsibilities to ourselves and our offspring, we lack the fortitude to deny ourselves anything in order to carry out these future responsibilities. As consumers, we stand second to one. In fact we lead the rest of the world by a wide margin. As such, we are the most likely testing ground for any potential product that can be conceived by the human mind. If we won't buy it in great quantities, it is likely that it can't be sold anywhere else on the face of the earth. More than that, we will soon come to regard any product as a necessity as long as we may have the money to buy it. It may be that the primary reason for our financial dilemna is that actual plans or goals in life are rarely set down. We often begin our adult lives without thought as to what we wish to accomplish. This is often carried onward through our married life where there is frequent incongruence in goals between the partners. Since there are no common goals or objectives

then there is no reason to practice thrift. James J. Hill, financier and the builder of the Northern Pacific Railroad, felt strongly on the subject of thrift and felt that it was the most important factor for one's attaining financial success. His often stated philosophy was:

> If you want to know whether you are destined to be a success or not, you can easily find out. The test is simple and infallible. Are you able to save money? If not you will lose. You may think not, but you will lose as sure as fate, for the seed of success is not in you /Popenoe, p. 165/.

In this country thrift is a virtue that has long been forgotten. The practice of thrift is difficult for most. It is a trait that must be learned, and experience is often the only teacher. As such, the importance of thrift is seldom recognized in our young lives, or practiced in our middle years. The full realization of its importance often comes in our old age at a time when savings are almost impossible. During the intervening years there are numerous excuses that may be used to avoid frugality.

Thrift is really the basis for any type of financial planning; obviously without some type of saving there can be nothing to invest. So, by and large, savings programs which are important in our futures and ultimate goals are poorly planned, if planned at all. Even in cases where some plans are made, the planning is rarely kept up to date. We usually start a savings program by setting aside a certain amount of dollars per week or month, and find ourselves saving the same amount many years hence. Yet all the forces that work to

the detriment of our financial security work on a proportional or a percentage basis. None of us would think of putting our consumer spending in terms of current dollars, but most of our savings programs are.

TENDENCY TO BLAME OTHERS

There is also a tendency for Americans to give up in carrying out their financial programs. Many view the well-being of others as impossible goals for themselves and resort to excuses such as "poor parents" and the "tax structure" on which to blame their own shortcomings. Profound platitudes such as "you can't take it with you," "the rich get richer and the poor get poorer," and "its better to be happy than rich" about in the conversations and thoughts of this category of individuals. Each of them would like to inherit some fantastic sum or gain a fortune through some stroke of luck, but they are remiss in trying to achieve some lesser but more practical goal through a realistic approach suited to their own means. The American does not realize that he could accumulate enough wealth to carry out all his responsibilities and provide a substantial retirement income for himself by wisely investing a small percentage of his salary. Many prefer to live in a world of fantasy, rather than save 5 to 10% of their salaries. Perhaps $50 to $200 a month invested over a long time period would be sufficient to provide adequately for most people. At the same time it is common to find people paying these amounts for car payments or on installment loans. This is a generally accepted practice.

THE EFFECTS OF PRIDE

Another human failing which brings about a great deal of our insecurity and unhappiness is, of course, pride. Very likely, those most in need of some sort of assistance or guidance in their financial affairs are the most reluctant to seek out the necessary help or even discuss their problems. As Americans we just don't like to admit publically or privately that we cannot afford some particular item that catches our fancy or that is being purchased by others. Another way in which pride affects our financial decisions is that we are ashamed to be able to invest only a small amount. There are countless Americans for instance who will not buy securities because they have only a few hundred dollars to invest at a time. They would like for the stockbroker to think that they buy only in round lots, and they are not going to let others know what small operators they are. Possibly they think everybody starts out with a great deal of money for investments. Those that are so inclined for impressing others must have a difficult time in ever acquiring a healthy investment attitude. On the other hand, large numbers of people who do buy stocks have very poor investment reasons or rationale in buying. Often they cannot even relate if it is for trading, growth, or income reasons that they are buying the stock. In addition they have not conducted research of the company in which they are buying an interest. They buy it because their grandfathers owned it, or because the name is appealing, or because their stockbroker recommended it and

he ought to know enough about it. It is enough for them to know that they own a part of the industry and business of America.

Another way in which pride is so detrimental to us is that it prevents people from being open and frank about finances. Finances are a very personal thing to most of us and we are reluctant to discuss such matters openly with others. Frequently we cannot discuss this within our own families. Because of this the young person is prevented from profiting from the mistakes of others, and if he does become something of a financial success it is largely due to his own experiences and learning. For these reasons there is little that can be gained from others in the way of practical experiences concerning personal finances or money management. Often young people start their lives without sound knowledge or exposure to any type of learning about money management. Parents are quite often poor examples to follow in this respect, and what little that is offered in formal instruction is of inferior quality.

CONDITIONING

Another important factor which prohibits or restricts Americans from pursuing a sound savings and investment program is the many long years of conditioning to which all have been exposed to some extent. Our financial plans and outlooks have adopted very low standards because of this conditioning. Americans have grown accustomed to spending all their incomes

and to living on false notions of financial well-being for a long period of years. Even when the federal income tax system was commenced, it was decided that a portion of the incomes would be deducted from paychecks because of the knowledge that the people would be unable to save up enough to pay their taxes at the end of the year /Pyle and White, p. 368/. Then too, Americans are constantly exposed to opportunities to become indebted. There are consolidation loans, executive loans, and about any other type imaginable. Banks are currently advertising to loan money based on the amount of the tax refund that an individual expects. As a further example of the low standards to which we have become conditioned the following criteria for "weathering financial storms" is restated in summary.

1. Add up savings accounts, checking accounts, bonds; if this amount comes to $200 give yourself an upcheck.
2. Give yourself another upcheck if you can pay off all installment balances within 12 months.
3. Give yourself another upcheck if you are paying less than 20% of your income for installment debts /"U.S. Families Owe Too Much Money," 20 April, 1974/.

Regretfully, roughly 50% of the population cannot pass the above test. The test shows the level of our aggregate ability to provide financial security for ourselves, and it depicts our national standards, attitudes, and common plight. Certainly those who just marginally pass the above test are already weathering a "financial storm." It does not require much imagination to see that many people can't do without their jobs for even short periods of time. The

government has to intervene, else our whole economic system would fall apart. A minor economic downturn causing unemployment has a disasterous effect on the people and on the country. Unemployment compensation has to be perpetually provided for those who can't get jobs for which the people of this nation are paying a dear price.

Conditioning also plays an important role in the types of investments that we finally select. Because of advertising and lack of knowledge and objectives concerning investments, many people have come to rely on banks and savings institutions as their sole means of investing. Granted this is a very safe way to store capital, but often this category of investors can least afford the high level of taxes they are paying or the toll inflation takes. There are difficulties in understanding which of personal income taxes or inflation is their greatest enemy. Even in periods of mild inflation, it will take the biggest bite from the investor unless he is in a very high income tax bracket, although its effects are more indirect.

Inflation has had a terrific impact in the last several years. The Department of Commerce has recently reported a 51% increase in the Consumer Price Index between 1968 and 1975. This means that if one had $100,000 of insurance in 1968, he would need to buy an additional $54,250 worth of insurance in 1975 to restore the same margin of protection that he had in 1968 ["Inflation and Life Insurance," AIDE, Jan. 1975]. The purchasing power of investments in savings

accounts and annuities are effected to the same extent. The economy may go through its usual "boom" or "bust" cycles, but these periods have recently been accompanied by inflation. Inflation is generally recognized as a structured feature of our modern economy because of the inverse relationship between it and unemployment /̄Reynolds, p. 120_7. Most Americans will laugh at stories about old misers saving money under their mattresses, yet they apply the same philosophies to their own investments. Americans have become "locked-in" on this type of thinking and changes in concepts are necessary before they can take advantage of better investment opportunities.

FINANCIAL SELF-RELIANCE AND THE LACK OF INDEPENDENCE

Another difficulty is that we lack aspirations for ourselves and financial self-reliance. Although economic freedoms were important principles in the foundation of this country, a sense of financial dependence and false notions of economic security have developed in many citizens. The plight of the poor is an area of growing concern, yet there are limits to the amounts of funds that can be set aside for their support. Welfare programs are needed to keep people from actual starvation, but they are generally ineffective in improving the conditions of the poor. Government social spending has tripled within the last ten years /̄"With Good Intentions," p. 29, 15 Oct, 1974_7, yet the percentage of all families earning under $3,000 annually also increased by a third in the same

general period /Marchal, p. 16_7. The situation of the poor is one of despair, hopelessness, and rejection. They are suspicious, distrustful, and depressed and they lack motivation to improve their lot. The average taxpayer has had to take on responsibility for a situation that is largely caused by the neglect of less fortunate. These are the same people that can always manage to save enough for a down payment on a boat, or a new TV set, or a new car; but this is the extent of their ability to plan for the future. They have very limited goals and are unable to save and invest on a long-term basis.

WHY THE PUBLIC DOESN'T RECOGNIZE THE EXTENT OF POVERTY

Most people don't often realize the extent of poverty that surrounds them for the problems of the poor and the old-aged are often invisible. The poor are shut-ins, segregated from society. They are out of sight in a physical sense; they spend their lives looking out the windows of delapidated housing onto a scene similar to their own. Those few that do come out may not be noticeable because America has the best dressed poor of all other nations. and it is easier to come by one outfit of decent clothing than to obtain decent housing or get the proper medical attention. Then too, the poor are often of the wrong age to be noticed. We like to think that the older people just dress that way. The poor are also politically invisible; they initiate no legislative programs and have no lobbies or representation. Influential people

such as congressmen, judges, governmental officials, businessmen, doctors, and engineers don't often come from backgrounds of poverty /Ferman, p. 11/.

SUMMARY

There may be numerous reasons or excuses why we can't start positive savings and investment programs, but ultimately it is our refusal to deal in facts. We have a tendency to "bury our heads in the sand" and avoid facts concerning financial matters, and we often fall back on some of our faulty concepts which we offer as excuses for our failures at being able to carry out any permanent plans. We do not recognize the benefits of long-term investment programs, and we do not appreciate the time value of money. Thus, we often condemn ourselves to conditions of poverty in our later years.

Money is not only dollars and cents. The accumulation of wealth is representative of our philosophy and personal attitudes toward life itself. Money should not be our sole purpose in life, but it is possible to attain some degree of financial security without our lives being entirely dominated or dictated by concerns about money. Freedom from financial worries is important to our overall state of happiness, and the proper use of money enables us to build a better future and enjoy a more useful life. With some basic financial planning where we set down some rules for ourselves, and abide by these plans and rules most of us can accumulate enough capital to meet heavy future costs and yet provide for ourselves through

retirement without being dependent on other sources. But some plans have to be started at an early age and some financial stubborness and "backbone" is required to carry them out. Once a positive program is started it gets easier as time passes and the individual does not have to be so concerned about his future because he has taken the proper measures in planning for it. If no steps are taken in this direction, it is likely that he will have to continually resolve money problems in the future to maintain the coarsest existence. Under these circumstances money is the controlling factor and finances must be taken into consideration almost daily for even the most mundane type of problem.

III. HOW THE MILITARY COMPARES WITH THE CIVILIAN POPULACE IN ATTITUDES AND CONCEPTS ABOUT FINANCES

MILITARY COMPENSATION AND BENEFITS IN COMPARISON WITH THE CIVILIAN

The same faults and shortcomings of civilians are also common amongst the military. Like the civilian the serviceman fails to deal in financial facts, has an abundance of erroneous concepts about money matters, and has no appreciation for the time value of money. The doctrine behind the military pay system is to pay enough so that when combined with the "fringe benefits," the serviceman can serve his country free of financial worries. The pay is not enough to allow a rapid buildup of capital, but it is sufficient for a gradual accumulation of capital to a fairly sizeable sum if the serviceman makes some early provisions and is not completely foolish. A career type will also receive substantial benefits at the completion of his service so that financial difficulties in retirement are supposedly eliminated. Thus the careerist is alleviated of many of the financial responsibilities which his civilian counterpart has to face daily. Throughout his career he can look forward to the security provided by the military retirement program, he can enjoy the security of his employment, and he may live in government furnished

quarters if he so chooses with a moderate reduction in pay. In addition he has lifetime medical benefits which give him a definite advantage over many civilians especially in retirement since these costs tend to become increasingly heavy in the later years of life. But because of all this security the serviceman has often been lulled to sleep in a financial sense. There is a great tendency for the careerist to feel too comfortable with his potential retirement benefits, so smug in fact that he does not see the need for saving a portion of his income for permanent investments. Many approach retirement with 20 years of service not having made the proper provisions, knowing that they will receive less than half the pay to which they have been accustomed. They still think that they will be able to maintain their standards of living on their retirement pay and that any income from employment will be extra. At this point the financial responsibilities usually do not diminish; if the individual has children to educate he may have to face financial reality for the first time in his life. The severe shock that such an individual experiences is even more pronounced if he has habitually taken government quarters and is now forced to purchase his own house or start paying rent in the civilian economy from a greatly reduced income. If the individual wasn't able to save some of his income, it is obvious that he was barely making ends meet during his active duty service when he was on full pay. Now he has increased financial responsibilities on one hand, and he has lost over half his income and the convenience of low priced government housing on the other.

The benefits are substantial, but the military often tends to overrate their value and also to think that the military is the only profession that receives such benefits. The value of total military compensation is significantly greater than the actual income received. One source concluded that basic pay ranges from 44% to 62% in the officer ranks of total compensation /Greenamyer Thesis, p. 41/. However, there are certain assumptions and subtleties in studies of this nature that tend to inflate the amounts. One of the reasons is that SGLI term insurance (and the bulk of all other insurance, for that matter) is not of any monetary value until the insured dies.

Other assumptions are that military personnel make the maximum use of their privileges; commissary, exchange, medical, etc. As is the military, civilians are entitled to Social Security benefits for the surviving widows and children and most industries have increased their "fringe benefit" programs in recent years. For 1973 the Department of Commerce estimated that the average military pay amounted to $8,997 as compared with average annual civilian earnings of $9,106; but the $8,997 for the military includes allowances for meals and for some other items which are not always furnished. In terms of actual pay, the average pay of the military still lags the civilian.

Another consideration is that the serviceman is more apt to be required to move from place to place during his career. While the government pays for the actual cost of these moves,

the serviceman loses heavily on the benefits that accrue from the long term ownership of a house or other property. The serviceman is naturally reluctant to invest in property, for it does require some management and it is difficult to manage from a distance. If the serviceman is able to save, he is inclined to put the savings in a form of investment that is phsically transferable from place to place. Many military people are aware of these disadvantages,but they consider their in service "fringe benefits" and retirement benefits more than adequate to compensate for the difference. For 1973 the U. S. Department of Commerce reported that "fringe benefits" for civilian employees average $3,230 from a nation-wide survey of 742 companies. A recent survey conducted by the Conference Board of 1800 U. S. companies ranging from small manufacturers with 250 employees to the largest industrials revealed the following:

> Health Insurance-The average company has basic hospital-surgical-medical insurance for all employees and their dependents. About 95 percent have major medical coverage for office employees; 85 percent for nonoffice people. Employee protection is noncontributory and, typically, the company and employee share the premium for dependents' coverage. Dental expense insurance is provided by 10 percent of the companies.
>
> Disability Benefits-Long-term disability insurance is provided for managers by 72 percent of the companies, for office-clerical personnel by 62 percent, and for nonoffice employees by 28 percent. Noncontributory plans have doubled in the last nine years to 50 percent. Typically, nonoffice employees' short-term disability coverage is provided through accident and sickness insurance; office employees' by salary continuation...

Death Benefits-Virtually all companies provide group life insurance. Approximately two-thirds of the plans provide coverage for retired employees, generally at a reduced level. There has been a fourfold increase in spouse's pensions in the last decade to 45 percent of the plans.

Unemployment Pay-Layoff and severance benefits are at about the same level as 10 years ago. Severance pay plans exist in 56 percent of the companies and the incidence of supplemental unemployment benefit plans is below 15 percent.

Time Off With Pay-Time off with pay has increased for all classes of employees. Many companies have reduced the requirements for three-week and four-week vacations by five years, but those are still typically given after 10 and 20 years' service. Companies have added two paid holidays over the past decade so that nine are now typical.

And you can add other benefits offered by many companies, such as Christmas and production bonuses, group-buying discounts on purchases, educational assistance programs and maternity leave-most of which are either not available to the military or are more limited to service people than they are to the civilian workers. /"Pay: Who Has More," p. 32, 26 March, 1975/.

These items narrow the often espoused gap between civilian and military "fringe benefits" and some of the military's benefits are currently under attack. On the other count, retirement income, the military is not alone in providing this form of compensation. The railroads have had pension plans for years and other industries have made recent progress in this area. About 87% of the companies surveyed had pension plans, with 8 of the 10 being noncontributory. Thirty per cent of the companies also reported deferred profit sharing, and 17% offered deferred profit sharing in addition to pension plans. The District of Columbia police and fire departments

both have non-contributory retirement plans based on 50% of salary, not base pay, at the end of 20 years; and the starting salary is over $10,000. Military retirement is still high in comparison to that of most industry, but it is contributory. Congress has consistently set military pay scales with 7% of base pay withheld to provide for the costs of the military retirement system. The imputed value of 7% is termed the retirement factor /"Pay: Who Has More," p. 32, 26 March, 1975/.

EFFECTS OF RETENTION PROGRAMS

No doubt, many of the inflated beliefs of servicemen concerning their retirement and "fringe benefits" are brought about by the emphasis in the recruiting process and in our "hardsell" retention programs. Rarely are the benefits of a military career explained objectively to the potential recruit or the man coming up for his first reenlistment. An individual getting out of the service constitutes a loss to the military in many respects, therefore one who is considering leaving the service is much sought after, as long as he meets certain minimum requirements. There are no set quotas to meet, but each command strives to maintain a good retention rate because the percentages are subject to review. For these reasons the serviceman is presented with a great deal of information about this benefits and privileges during the term of his enlistment, and the "first termer" is likely to be subject to an intensive program of one-sided propaganda. Much of this

information is entirely factual, however few if any comparisons are made with job opportunities on the industrial market. This situation is often highly emotional and a rather gloomy picture of prospects in the civilian environment is often presented. The case for the military is presented in such a fashion that the man is made to feel that he could be making a bad decision for life if he should choose the other course. This type of pressure often causes the man to make his decision without sufficient knowledge of opportunities in civilian life. Since the individual is unable to weigh the possibilities against each other, those who lack the proper motivation for the service are apt to become disgruntled during their next reenlistment because they feel that they have been talked into reenlisting. In this respect the military often does itself an injustice. By not presenting the facts objectively the "border-line" cases tend to become malcontents which is, of course, counterproductive to the ultimate goals of the military for maintaining a core of high quality personnel.

FAILURE TO EDUCATE

Another fault of commands is that they fail to educate their personnel in financial matters. The military has instituted several programs in this regard, but they are largely ineffective. For example the jobs of Personal Affairs Officer, Insurance Officer, Legal Officer, Savings Bonds Officer are most often assigned to the most junior man permitted, as a collateral duty. As such, it follows that he may not be

qualified to advise others about their financial affairs. Drives to collect a few dollars per man for the Combined Federal Campaign or Navy Relief Society receive much greater emphasis.

The services could save themselves many manhours of administrative work if some knowledge of finances could be imparted to all personnel. As a result of our shortcomings in personal affairs the typical serviceman's knowledge is very limited. He is informed that he should have a will and of the procedures for having one drawn up, and he is informed about his financial responsibilities to his family and creditors in as much as irresponsibility in this area can be reason for adverse administrative action. Other than this he receives relatively little worthwhile advice, other than to be swamped with information about the benefits of a career and his pay entitlements. Thus,the younger persons in the military have little knowledge in an area that is vitally important. A great deal more attention needs to be directed to the area of personal affairs so that the serviceman is caused to recognize the importance of making major efforts toward his future. He needs more than knowledge of how to make the short-term decisions of financing a new car, getting a new set of uniforms, or buying a washing machine. Indeed,the serviceman's knowledge is often limited to how much his pay check should be.

THE SERVICEMAN'S NEED FOR KNOWLEDGE AND SELF-RELIANCE

The ability to make independent, rational decisions about his own personal affairs is vital to the serviceman. They are a necessity to develop self-reliance and resoluteness in his own financial program, rather than being wholly dependent on others for guidance. Some competent advice may be useful from time to time, at times it is essential; but others cannot solve all of these problems. The financial consultant may be able to point out certain areas where the individual is overspending or offer him better investment opportunities, but he cannot save the money himself. The lawyer can draw up plans for the estate only after the individual has made certain decisions about his own situation. The serviceman needs to be able to evaluate all the information that is provided and base his decisions on those evaluations, but he should not turn over the complete responsibility for his future to others. Our reluctance to think for ourselves in the area of personal finances is a major weakness, and when we try this our decision is often clouded by rationalization. We operate some of the most complicated equipments and systems known to man and many are in positions of making decisions which have an impact on our national security, but many refuse to develop ourselves in an area which requires little more than practical application, rudimentary knowledge, and determination. Besides our susceptibility to taking the recommendations of others without evaluation, we like to have

our affairs put into automatic. We don't like to be personally involved in our own affairs, and we like arrangements that require a minimum of revision.

In response to our financial problems, there has been a tremendous growth of estate planners and financial consultants in recent years. There is a concentration of them around military installaments, and most perform beneficial services to the public. However, many people come to them who have overspending problems that can only be resolved by the people themselves. Such people are likely already heavily indebted and may have been unable to save. As such, they cannot absorb or respond to sound financial advice. They need some wild scheme to earn an unheard of return to make up for their neglect. Even if some grandiose scheme were possible, it would be difficult for these people to retain their new-found wealth for there is difficulty is altering practices that have been developed in early life. And as excellent as many of the consultants are, some are nothing more than glorified insurance salesmen who consciously aim to take advantage of customers by telling them that their purchases are a mark of the love and devotion they have for their families.

It would be wise for the potential customer to look to the method by which these individuals are compensated for their efforts. If the service is advertised as being free it should be highly suspect, for the customer may well find himself strapped with excessive long-term committments so that

the consultant can earn an exhorbitant commission for his services. The other method of compensation is where the consultant receives payment directly for the time and value of his services. The former type of advertising has a way of appealing to the public and therefore it is a common business practice. A few hundred dollars seems like a lot of money to pay for the service on the front end, but the expense may be even greater if the consultant is compensated from commissions which disguise the amount of payment. If the customer ends up with a few insurance policies, for instance, he pays that much in commissions alone in the first year. Regretfully the paying does not stop then.

With his limited knowledge the serviceman is often faced with several rather unfavorable options for starting his financial program. First he may become discouraged and avoid the problem altogether. Secondly he may pursue some program independently of guidance and advice, in which case, he probably faces numerous setbacks before he can gain the necessary experience in the higher risk-higher reward type of investments. If he is more conservative, but wants to remain independent, he will likely resort to investments in savings bonds or accounts where his program can't keep step with the economy. Lastly he may seek "professional" advice in which case he may find himself overloaded with insurance policies, annuities, endowments, and the like.

IV. COMMON PITFALLS

There are four major pitfalls common amongst the military, any one of which may preclude the younger serviceman from achieving the maximum financial results. The are:

1. infatuation with new automobiles.

2. tendency to rent or live in government quarters.

3. if there are savings, the savings are likely to be concentrated in "loaner" type investments yielding low returns.

4. tendency to be paying so much for insurance that there is nothing left for investments.

THE AUTOMOBILE

There is probably nothing that prevents the serviceman from pursuing a substantial investment program more than the automobile. The purchase of a new car represents a large capital outlay in proportion to the military salary and new cars are bought, almost invariably, on credit with a minimum down payment. In general, we attempt to obtain the loans over the longest periods possible to minimize the amount of the monthly payment so that the actual cost is substantially greater than the price. Cars are something of a necessity in our society, but we are so infatuated with colars, designs, and new models that new ones are financed before the old one is paid off. Indeed, many servicemen are heavily indebted

throughout their careers for new automobiles and also for boats, campers, and trailers which we have come to regard as basic necessities of life.

Often there is very little actual need for these purchases. Instead the buyer bases his decision on his ability to make the payments. Very poor rationale such as "The old car is almost paid off" and "I'm getting a pay raise soon so I'll be able to make the payments" are commonly offered as reasons for buying. The amounts that go for monthly payments on these items alone would be more than sufficient to build a sizeable estate if invested wisely over a period of years. It seems strange that the serviceman will hold himself accountable to his creditors for making such payments, but he will not be accountable to himself in setting up a financial program that would be of great benefit in his future.

RENTING OR LIVING IN GOVERNMENT FURNISHED QUARTERS

Military personnel have an inclination to rent or take government quarters whenever available. Renting of quarters may prove to be advantageous at times when the tours of duty at a location are short, but the individual who takes this course throughout his career may suffer economic consequences. Quarters are especially attractive to some because they are furnished for a small reduction in pay and there are no utility and repair bills. Quarters and rentals are similar; they are both convenience items that may offer short-term benefits. By renting or taking quarters, heavy closing costs,

real estate or property taxes, responsbilities for repairs, and the down payment on a house can be avoided. If the individual makes his policy that of renting or taking quarters whenever available without some awareness of what he is doing, he makes a serious mistake; one that can be costly and burdensome in the distant future. Since the real effects do not "hit home" until late in life, the serviceman can operate in a "vacuum" throughout his career, never realizing his error until it is too late to do anything about it. Establishing control over the expense of furnishing a place to live is an important item in the planning of most estates, and ownership of a house is one of the most obvious methods of building an estate, since there will always be a requirement on the individual to provide housing for his family. In fact, buying a house is the largest investment ever made by the majority of Americans.

It is of the utmost importance that a serviceman always own at least one house that is comparable to the standards of a home that he would live in himself for the ownership of a house is an important factor that will allow him to retain a greater portion of his retirement income in the future. He does not ncessarily have to hold on to each house he buys, unless he elects to make all his investments in real estate, but he must maintain an equity in the same quality of house that he desires for himself. The cost of providing shelter is a cost that cannot be avoided. A portion of the cost may

be deferred, but eventually it will have to be borne. Home ownership may be delayed, but each year of delay results in already heavy and rising costs. The sooner the individual can acquire the necessary capital for the down payment and is able to manage the mortgage payments, the better off he is.

A great many servicemen make money on the sale of their homes when they are relocated, however this additional capital is often required as a down payment for the new house and the realization of that capital should not be the primary purpose for buying his own home. The ownership of a house, although he may choose not to live in it, will keep the serviceman in step with the economy and will preclude a heavy capital drain should he eventually decide to purchase a house to live in. This is the primary purpose of owning. It may be thought of as forcing one's self to make the monthly payments in order to avoid even higher costs in the future. The owner obtains leverage and buying early permits the securing of the property during the high income producing years. While inflation may have an effect on the more minor expenses such as taxes, utilities, and insurance coverage the major expense of owning a house, the mortgage payment, will remain constant over the years. At some point, the owner will be making relatively low monthly payments for the same house for which the renter will be paying a much greater price. In addition to securing the comparatively low payments the owner also benefits from an equity buildup. Inflation actually works

to the advantage of the owner in this respect along with several other benefits of ownership; the house will appreciate in step with the amount of inflation. Conceivably, the owner may be able to pay off his mortgage not long after retirement so that his cost of providing shelter is then reduced to minor repair bills, utilities, insurance, and property taxes. If the owner should choose to obtain a larger or more expensive house at any point, he can apply the equity from his previous house to his purchase.

There are a great number of individuals who try to compare the amount of their BAQ or rental payments with the mortgage payments and other expenses involved in buying and owning a house to determine if it is financially better to buy, rent, or live in government quarters. In most cases the individuals make their decision based on which has the apparent minimum cost over a short time span. The long-term benefits of ownership, the effects of inflation, equity buildup, appreciation, and the tax advantages of owning are not taken into account. Even if these factors were taken into account the value of the calculations would be highly debatable. A meaningful financial analysis by net present value methods is impossible, for all practical purposes, because cash flows are uneven and unpredictable, future costs are unknown, and the time horizon is extremely long. Policies about owning which affect the entire lifetime should not be established on short-term decisions because the elements are too involved. But many in the military do just that. The usual tactic is

to resort to the alternative which minimizes the immediate cost. As previously noted, the danger of this reasoning lies in the fact that the financial impact may not be fully realized until many years later.

The renter is at an obvious financial disadvantage. He may be protected temporarily from inflation as far as the amount of his rent by the terms of his lease agreement, but he is forever at the mercy of the economy and inflation. His major expense of providing shelter, the rental payment, will increase with inflation along with his utility bill. He will not be in control of his own situation, and he is powerless in preventing economic conditions from having a drastic effect on his standard of living. In retirement he will be paying a sizable portion of his retirement income for rent on which he will never get any return. Not only do his costs exceed those of the owner in the long term, but he gets no tax break and has no build up in equity or appreciation.

As an example, consider the relative capital positions of the renter versus the owner over the next 20 year period. At the present, the renter may expect to pay a minimum of $250 per month ($3,000 per year) to $400 per month ($4,800 per year). If there were no increases in the costs of housing the renter would pay $60,000 to $96,000 in rental payments over the next 20 years. If housing costs continue to rise as they have in the past, he will be paying $600 to $800 per month by the end of the 20 year period as a very conservative estimate. The owner and renter get the same quality of house for about the

same cost per month initially, but during the period the renter's monthly costs will increase in relation to the owner's costs. Throughout the period the owner benefits from ownership. At the end of the period he will own a good portion of that $60,000 to $96,000 minimum that the renter threw away, and he may well have a greater claim in equity than the amount paid on the mortgage. It is only here that the real advantages of ownership become evident for at this point the renter will be paying considerably more per month, and he has no claims in assets. If the renter finally decides to buy at this point, he must prepare himself to pay proportionally higher mortgage payments or have a large amount of capital to secure the lower payments.

In general, the individual who habitually takes quarters faces the same problems as the renter. The advantages of ownership may not be so apparent as in the case of the renter. The cost of quarters is relatively low so that this may lead to delusions about the differences between the costs of housing in the military and in the civilian world. This should be his primary concern for eventually he will be forced to operate in that climate. These problems may have less effect than on the renter if he has always forced himself to save and invest specifically for the purpose of buying a house. It must be pointed out that saving the difference between the BAQ and the costs of owning is a key assumption in the decision to take quarters, but those savings are often difficult. The homeowner effectively gets a good return through ownership

almost automatically. If the quarters taker were able to save the increment between his BAQ and the costs of owning a house, he would be hard pressed to earn a return equal to that of the owner in the long-term. The owner has geared himself to the economics of the country, and he has paid the majority of the heavy costs of a home already. He is in an especially good position when his mortgage is finally paid. He owns all the equity in the house, and the costs of the house are then at a minimum so that the major portion of his income may be used for other needs as he pleases. Up to this point the individual in quarters has experienced much less expense than the owner, but it may now be difficult for him to get to the position enjoyed by the owner. He may either rent or buy, but at this time the rental payments or the mortgage payments will be relatively high, taking a larger portion of income. To get to the same income position as the owner the individual would have to buy outright, and neither that or starting paying off a heavy mortgage at that point in life are advantageous methods of securing property. The more sophisticated investor can turn the difference between the amount of BAQ and the costs of owning into a long term benefit, but he must take some risks to earn an equal return. The point is that owning is a "built-in" investment on an item that will always be required so that taking that degree of risk on the marginal gain is unnecessary.

In the long run it is simply illogical to rent or take government quarters. The money paid for rent or that given

up as BAQ is truly wasted since it could have been applied to the equity in a house. That money can never be recovered. Unless the renter or quarters taker has saved a considerable portion of this income expressly for the purpose of buying a house in the future, he may well be forced into renting for the rest of his life.

CONCENTRATION IN "LOANER" TYPE INVESTMENTS

Of those servicemen who do manage to save, there is a tendency to have all savings committed to "loaner" type investments. Basically this is any arrangement where the individual allows someone else the use of his funds. The return paid back to the investor is obviously less than that being earned on his capital. This form of investment is conceptually wrong for most people because it sets a ceiling on the return and limits the potential of the capital being invested. Examples of "loaner" investments are savings accounts, savings bonds, annuities, and permanent life insurance programs. They offer only one advantage--safety. For the careerist, this degree of conservation is not necessary because an ample margin of safety is provided by the stability of employment, by the retirement benefits, and by other benefits made available through the system of compensation. Thus, the careerist can afford to be more speculative and he should be in order to achieve a measure of balance in his investment program. Adding the safety of "loaner" type investments to the safety

already provided by the benefits of the military career is not complementary to the financial objectives the serviceman should be pursuing and shows a very poor design in the investment program.

"Loaner" type investments are very poor means of storing capital. They earn a low rate of return and this return is usually taxable. While some of them do have tax advantages, all are exposed to the full effects of inflation. The investor has little chance of maintaining his purchasing power. There must be something magical in "guaranteed cash" and "tax-sheltered" because there are literally millions who are very pleased to be putting their entire savings into insurances, annuities, savings accounts, and the like. Some of these may be means of forcing savings, but there are other means that are just as convenient and more rewarding. "Loaner" investments should be used for the purposes of forced savings only when the savings cannot be accomplished by any other means.

While this type of investment is a poor choice for the serviceman to accumulate capital, it may be attractive to him in that it requires no management and no thought. Several areas of "owner" type investments-the stock market, real estate property, land, private business, and the commodity market all offer great potential for obtaining a high rate of return; but becoming proficient in these areas often requires time and skill. As a rule the serviceman cannot dedicate a great deal of time from his professional life to these areas, and in the case of a private business, he would

not be able to participate unless in an exceptional situation. However, all these areas offer opportunities and advantages that cannot be overlooked nor can they ever be obtained through the savings account, insurance, or annuity approach. The serviceman may not have the time and knowledge to become a skilled trader in stocks or a land developer, but he does have the time to invest in these areas. He may gain from the benefits of this type of "owner" investments through the same principles as the more skilled investor.

If certain approaches are taken with "owner" investments, they require little more time than the "loaner" types. They do take a bit of management and personal involvement, but this is not prohibitive. Some are better at certain times than others and in any event the serviceman must select the type which are suited to his own personal situation and personality. Also, while some offer great potential they involve considerable risks. The serviceman can hardly afford to carry these risks when deployed. Should he select the more volatile ones, he likely has need of professional management or a family member who is capable of handling all situations in his absence. Even then, he should only undertake them if he is fully prepared to he risks. But he must examine the field and choose those that have risks with which he can cope. His financial program needs to be based on potential rather than minimizing risks.

The serviceman simply cannot afford to sacrifice good potential for safety. He needs the more speculative investments. Our system of taxation is set up to encourage ownership and equity investments. The serviceman may take advantage of this in addition to combining good returns with the protection of purchasing power through "owner" investments. In fact, if the serviceman has high goals, he must have a good rate of return to accumulate a large capital base for his salary is too limited to obtain enough of a base to preclude depletion at the "loaner" rates of return. Of course the "loaner" investor can accumulate the same amount of capital, but he would have to save a large percentage of his income and impose rigid standards of living on himself and his family in meeting his objectives. The individual who learns the value of a few extra percentage points and seeks out investments where these percentages are likely to be gained can accomplish the same objectives much less painfully.

INSURANCE

- The Need For Capital Funds In The Event of Death Of The Serviceman

There is a need for a large amount of capital funds in the event of death of a serviceman. Fortunately Dependents Indemenity Compensation (DIC) and Social Security benefits (SS) give the active-duty serviceman a substantial advantage over their civilian counterparts. In my own case (a LCDR with 14 years of service with a wife and three (3) children) the monthly income that would be paid to my survivors would

exceed $1,000 per month assuming my death occurred in 1975. Since as a general rule, $1,000 of insurance is required to provide $5.00 of monthly income, an individual with no SS or DIC benefits would have to have about $200,000 of insurance to provide the same $1,000 of monthly income. In addition Dependents' Education Assistance (DEA) presently provides $220 per month for 36 months (a total of $7200) for each child between the ages of 18 and 26 who is a full time student in college or other approved institution. Seven thousand two hundred dollars seems a substantial sum, but, even at the present costs of an education in a good private college, it would only support the education of one child for about one year. It is reasonable to assume that the costs of higher education will always exceed the amount contributed by DEA perhaps by an even greater margin in the future. Thus in the event of death, some fairly sizable capital resources would be required in addition to the DEA benefits for education alone.

Aside from the costs of education, there are some immediate problems that the widow would face. In the case of a LCDR with 14 years of service and 3 children, the widow would receive about $11,600 annually after taxes which is a large percentage reduction in income. In terms of actual income the $11,600 represents a 36% reduction. Still yet $11,600 sounds substantial enough to provide adequately. But in many cases service families are dependent on pay hikes just to make ends meet, and they cannot absorb a change in the negative direction.

In fact, a mere $50 per month cut in pay would be difficult for many, and the cut to the widow's income is over 10 times that amount in this case. Service people may tell themselves that since there is one less family member there will be less costs and everything will work out, but in reality this does not occur. The loss of a member of the family doesn't mean that there will be a corresponding proportional reduction in family expenses. Some of the more major expenses such as house payments, rents, property taxes, utilities, etc. will not decrease at all. The major costs of maintaining the household will remain.

If savings could not be accomplished on the serviceman's income, it follows that savings from the reduced income after his death would be even more difficult. This automatically means that the family takes a reduction in living standards. If there was a savings program prior to the death of the serviceman, it is now apt to be curtailed so that the necessary capital required for educational funds cannot be built up to the necessary levels. Under these conditions something has to give. Either the educational programs will have to be scraped, or the widow will have to obtain employment.

- Problems of Survivors

Related statistics from the general populace show the hardships endured by survivors. These statistics show that the most common manisfestation of a lowered standard of living was a pervasive sense of concern about money. There are common fears about money at this point and a fear of

acquiring more debt and there was a realization that all unnecessary spending would have to be cut back /‾LUTC & LIAMA STUDY, vol. 1, p. 14_7. Clothing, social and recreational activities, and food were the specific areas in which cut backs were most often reported. (Note that savings was not included as an item which was often cutback, and that two of the items reported most often, food and clothing, are basic necessities of life.) This and the fact that most of the widows have to use the principal from their life insurance proceeds for living expenses indicates that there were no savings programs before the primary breadwinner did. /‾LUTC & LIAMA STUDY, vol. 2, p. 38_7.

Forty seven per cent of the widowed mothers said that their financial situations had had an effect on their children's lives. When a change in educational plans was foreseen by the widows, they spoke most often of altered financing. In particular, they stated that the children would bear more of the costs themselves. Of those widows who had to face the cold, hard facts of reality, those with children already in college, a great percentage of them spoke of interruption or termination of the education, thus it seems that those with younger children are unable to anticipate the ultimate impact of the loss of the husband's income /‾LUTC & LIAMA, vol. 2, p. 47_7. There is only a slight increase in the percentage of widows that obtain work within the two year period after the husband's death. This is probably related to the amount the widow needs to earn to show a net gain in income because of other expenses

that arise from employment. The statistics seem to bear this out since a disproportionately large share of the widows who went to work came from the $10,000 and above income brackets, and since there were actually net decreases of widows working from families earning $5,000 or less. Of the widows that worked, 93% reported that they needed the extra income [LUTC & LIAMA, vol. 2, p. 14].

In 1972 about 70% of the adults in the United States owned life insurance averaging $22,000 of coverage [Newman, p. 126]. If this is the only source of capital, it is obviously insufficient to support an average family for over two or three years at the most without considering the final expenses. Statistics show that in addition to the loss of the husband's income, the average widow was faced with $3,900 of final expenses in 1966. The average medical expense amounted to $1,740, and the average funeral cost was $1,510. The medical and funeral expenses together amounted to 83% of the aggregate expense that the widows had to meet [LUTC & LIAMA, vol. 1, p. 24]. There was also evidence of subsidation of medical expenses especially among the lower income families. In the $15,000 or greater income bracket 18% of the widows paid more than $10,000 in final expenses [LUTC & LIAMA, vol. 1, p. 28]. Statistics show that over 8 of 10 widows have to use some of the proceeds from life insurance to meet these final expenses. Sixteen per cent of the widows where adjusted total family income ranged from $10,000-$15,000 in 1966 exhausted all proceeds in the immediate post death period, and 8% of

those in the greater than $15,000 income bracket were not able to retain any of the principle beyond the post death period. Considering all income brackets, 24% of the widows expended all the proceeds in the immediate post death period /LUTC & LIAMA, vol. 1, p. 70/, and likewise 24% of the total of all insurance dollars paid out were spent in this period /LUTC & LIAMA, vol. 2, p. 11/.

Because the income from the average proceeds of life insurance is so small, the principal must be drawndown and cannot be retained in most cases. Only 9% of all widows even have hopes that they can retain all the principle and use the interest as income /LUTC & LIAMA, vol. 1, p. 75/. From an average payment in insurance proceeds of $9,950, the 76% who manage to retain a portion of the proceeds after the final expenses started out with an average of $8,100. Of this group 14% have exhausted all remaining proceeds and another 44% have used up at least some of the principle within a 2 year period so that the balance of the widows then have $6,350 of proceeds remaining on the average /LUTC & LIAMA, vol. 2, p. 72/.

An interesting aspect of this study shows that only a small percentage of the widows from all brackets of families whose family incomes had been less than $15,000 manifested the lowered standard of living by moving out of their homes or apartments. Over three times that percentage of widows from the $15,000 and greater bracket moved to less expensive accomodations. Interviewers' efforts to locate widows indicated

that as many as 44% moved within 2 years after their husbands death. Nine per cent of the homeowners had moved in comparison with 31% of those who had been renters /̲LUTC & LIAMA, vol. 2, p. 92_7. It is also interesting to note that the financial strength of families from all income brackets increased by large percentages from life insurance after the deaths of the husbands. Of those families who had had pre-death incomes of $5,000-$10,000 the median financial assets increased from $600 to $2,950. In the highest category, the $15,000 and over income bracket, the median financial assets increased from $11,600 to $28,350 /̲LUTC & LIAMA, vol. 2, p. 89_7. Proceeds from insurance comprise the major portion of all the financial assets of all the groups. Twenty eight thousand dollars is a relatively large sum of money, but there are only a few who could survive on the interest from this capital base.

On the more personal side of the issue the widows were questioned as to who were most helpful during the course of settling their husband's estates and in applying for widow's benefits. The life insurance man ranked well down on the list below the company official and mortician, even with the banker and union representative, but slightly above the physician and probate judge, the two remaining choices /̲LUTC & LIAMA, vol. 1, p. 42_7. Despite common beliefs that new widows are besieged with offers of advice, only 1 out of 5 talked with anyone about the use of life insurance proceeds /̲LUTC & LIAMA, vol. 1, p. 67_7. Of those who did receive

advice from life insurance agents, 61% of the agents recommended taking income options or annuities, interest options, or buying additional life insurance. Only 1% of the attorneys, 6% of the bankers, 0% of the security salesman, 0% of the friends, and 5% of the relatives recommended taking this approach. Almost no one else recommended the life insurance alternatives /LUTC & LIAMA, vol. 1, p. 69/. Three per cent of all insurance proceeds were lost to widows because of policy loans, contested policies, or designation of beneficiaries other than the widows. Pathetically, this loss struck hardest in the low income groups, where 10% of the total insurance proceeds were either withheld or paid to someone other than the widow /LUTC & LIAMA, vol. 1, p. 73/.

- Life Insurance as a Means of Providing Capital

There is probably no area that is more important to the average American or about which there is less consumer knowledge than in the field of life insurance. For the young person without capital it is an excellent means of immediately creating a sizeable estate. It is also an important and manageable element within the framework of one's estate. In all too many cases, however, life insurance comprises the largest part of the estate and even then the amount is often far from adequate. The very nature of military duty should cause military personnel to examine their personal affairs and insurance programs at frequent intervals. This aspect of the estate plan is often ignored because of pressing military responsibilites and activities or because the value

of the DIC and SS benefits are overestimated. As mentioned previously the serviceman does have some very definite advantages over the civilian while on active duty, but he loses a portion of those benefits at retirement. He should be able to fill in this gap with capital from sources other than insurance. If he does not have that additional capital, this presents a very real problem commonly called "blackout" because there is then a need for insurance to provide protection until the spouse reaches age 62. This need comes at an age when the cost of insurance is excessive. Of course, this need could have been anticipated and prevented by buying extra insurance at a young age, but that is also expensive.

In almost all cases insurance should be brought with only one objective in mind; that of providing a certain level of protection when there is no other or too little capital available from all other sources. It is not a good investment by any stretch of the imagination. It should be thought of as a cost of providing that amount of protection. Therefore, it should be purchased only when a real need exists in minimum amounts at the minimum available cost, but only then if the consumer has the right reasons and knows what he is paying for. All too often insurance is used as a means of "forced savings" to provide an education fund for the children, to supplement income during retirement, to create a housing fund, and a score of other items. Because of its low rate of return and its susceptibility to inflation, it is the poorest method that one may choose to finance such programs. However, a very

large portion of the public buy it with these very objectives in mind. Insurance is insurance and investments are investments; trying to combine the two is an extremely costly proposition. There are certain tax advantages in owning insurance. So called dividends which are really refunds for overcharges are not taxable, and there are also advantages in payments to beneficiaries out of the proceeds. However, there are other methods of "forced savings" which are just as convenient that pay much better returns. People buy permanent insurance thinking they are killing two birds with one stone. They think they are getting something for nothing because most plans illustrate that the individual will get all his money back in 12 to 15 years. There is nothing necessarily wrong with buying permanent insurance; some financial programs require it. But using the cash value is a grossly inefficient method of financing any objective. Designing an entire financial program centered around any insurance program is a serious and costly mistake.

- The Consumer and the Insurance Market

Hearings before a Senate Subcommittee have revealed that the public is basically deceived by the large insurance companies through misrepresentations of facts about the nature and real price of the commodity. The hearings determined that these companies have received little scrutiny from governmental agencies and that they have subdued criticism of the industry by private attempts to remove critics from their positions. The public is generally shortchanged in the value or benefits

it receives in return from annual premiums for life insurance alone which rivals the amount paid to the federal government in federal income taxes. The companies have capitalized on the ignorance of its customers and have gained control of billions of dollars from the difference between the payments and the values returned. Inefficiencies and exorbitant expenses abound within the companies; the brunt of which is borne by the customer. There is actually very little regard for the customer's real needs. In the eyes of the company, the policyholder is merely a contributor to the assets. This gross waste and efficiency has been largely covered up and removed from the public eye because attempts by the Securities and Exchange Commission to put life insurance profit reporting on an equal basis with other industries have been blocked or delayed [Congressional Hearings, p. 7].

Since there is no meaningful competition in terms of value to the consumer, the companies are allowed to earn large "surpluses" and to operate on wide profit margins from the incoming premiums and their investment income. In fact the profit margins are so wide that the companies are not even concerned about the saving of lives through various health and safety programs. Instead of directing minor amounts of their vast resources to research or advertising to prevent deaths, they engage in multi-million dollar promotional programs [Congressional Hearings, p. 27]. Another indicator of the protected margin of profits is that the insurance stock

index gained 26.05% in 1972 against a rise of 14.58% in the Dow Jones Industrial Average. This was the fifth year in a row that insurance stocks produced good results in relation to other markets and it was the second consecutive year that it noticeably outperformed the major indexes [Congressional Hearings, p. 300]. In general, consumers are ignorant about the amount of insurance they need, the types of insurance that is appropriate for them, and about the large price differentials. There are so many variations, options, riders, additions, etc. that the consumer cannot make an intelligent choice. There are also numbers of deceptive sales practices ranging from misallocation of the interest factor to presentations that are outright false so that the consumer receives an erroneous impression of the important relationships [Congressional Hearings, p. 546].

The combination of these deceptions and half-truths is configured in such a fashion as to influence the potential customer to buy or have guilt feelings about being unable to provide the proper protection for his family. For example one of the salient features of life insurance is that the monthly income proceeds would not jeopardize a family's Social Security benefits as would a widow's earning from employment. (Neither does the return from investments). Another major gimmick is the "flexibility" and "adaptability" that the policy owner would get from a permanent policy since it combines protection and "investment." In the illustrations and presentations the calculations are sometimes exaggerated

to show a rate of return from the "investment component" that is competitive with bank interest rates, when the effective rate is actually more likely to be about 2-3%. If the effective rate is presented to the customer, it is apt to be accompanied by the convincing sales "pitch" of "Yes I admit that 3% is not as good a return as you can get at a bank, but I look at it this way. Its better than nothing, and if you brought that other kind you wouldn't get any return."

Intermingled with these tactics, there are numerous methods of illustrations such as the level-price, benefits-premium, traditional net cost, or the newer "interest-adjusted" methods all of which are designed to conceal the real issues with which the customer should be concerned. All in all it is such a complicated distortion of facts that the salesmen themselves often present these deceptions unknowingly and unintentionally. The industry then loans out the premiums at the prevailing market rates to activities needing large amounts of capital funds. They obviously get the highest rates possible. There is nothing wrong with that, it's just good business. But it should point out that the average people are, in reality, financing a very large portion of the businesses of this country. Much of the massive returns from this financing does not benefit the policyholders. Instead it goes into "surpluses," profits, plush office buildings, advertising, and commissions. As a result the distribution costs are high in comparison to other industries [Congressional Hearings, p. 10].

In a nation where insurance plays such an important part in the life of the average individual there is an urgent need for improving consumer knowledge and providing him protection. Exerpts from hearings before the 1973 Senate Subcommittee on Anti-Trust and Monopoly are contained in Appendix A.

There are general feelings that term insurance is not as substantial or solid as permanent, and that buying term is like throwing good money away because one gets something back from the other. This "How much will I get back" conception presents a very real problem. The "How much will I get back" question is largely irrelevant to the decision to buy insurance. It is generally applicable only when comparisons are being made between two permanent policies, or if insurance is being compared with an investment opportunity. The best decision rule to use in buying insurance is how much does it cost per amount of coverage. If there is a difference between the costs of a term and a permanent policy, the difference may be thrown away as long as the same amount of protection is provided; except in cases where the insured is dependent on that particular cash value to finance an objective in the future. The buildup of a cash or loan value in a permanent policy is largely inconsequential because that value cannot be obtained without giving up coverage or taking on that amount of debt. Even when the insured dies the cash value will not be added to the face of the policy. It has no significance at this point because it provides no additional protection.

- Difficulties in Choosing Between Term and Permanent Insurance

With the knowledge the consumer has when he comes to the insurance market, it is difficult for him to make a logical choice between term and permanent insurance from an array of presentations. A great deal of confusion remains and there is still controversy about this because both types have advantages and disadvantages. Aside from the perspective and approach of the customer the difficulty in making the determination between types is also caused by the uncertainties of the future. None can predict his time of death or the importance of insurance in his financial program at the time his death will occur. Because of this unpredictability the alternatives are difficult, if not impossible, to analyze in terms of comparative financial benefits. As such, the determination is frequently made emotionally, whether it is a personal conviction, or a response to salesmanship, or a whim. With the lack of quantitative data the decision between the two basic types must be based on the objectives and concepts which support the individual's financial and estate program. The insurance one purchases should be dependent on the individual situation and the design of the entire program. Before discussing the relative merits the elementary rules for buying insurance are summarized as follows:

1. No more than the amount needed should be purchased.

2. It is not a good investment; it should be bought only for protection.

3. The type should be selected according to the individual needs and the objectives of one's financial and estate program.

4. The selection of a particular policy from the type chosen should be based on the minimum cost per amount of protection provided, other factors being equal.

- Brief Discussion of Permanent Life Insurance

Permanent insurance is normally a level-payment plan combining the features of providing protection and forced savings. The cost is much greater than term, but it has a cash or loan value after the first year or two. In effect the cash value is a kind of a savings account yielding 2-3%. It may be withdrawn by surrendering the policy, it can be used as collateral for a loan, or it may be borrowed by the insured at a specified rate of interest (usually lower than bank interest rates) according to the terms of the contract. The policyholder can retain the policy for as long as he wishes if he later becomes uninsurable and the policies may be written so that some benefits would be received should the policyholder become disabled. It is normally a better buy than term if the individual has no prospects of accumulating capital by any other method or if the individual determines that he will always have an increasing need for insurance in his program provided that he can afford to buy the bulk of the insurance in his younger years for the lower premiums. <u>If there are good probabilities that the cash value will be required to finance a need in the future, it is generally a better buy than term if the insured can earn no more than about 5% after</u>

after taxes on the difference in premiums. Otherwise the cash value has no relationship to the difference in premiums, and the customer should choose whichever has the lower cost per amount of protection. Permanent insurance programs do not allow flexibility because of the long term contractual relationship. Policyholders have an inclination to try to retain their policies at least until such a time as they can recover most of their real dollar equity, and they have a tendency to add to their permanent life insurance programs as time progreses in order to maintain a level amount of protection. Some investors who have high incomes sometimes depend on the buildup of cash reserves as a measure of safety if their other investments are more speculative in nature.

- Brief Discussion of Term Insurance

Term insurance provides the maximum protection for the lowest cost andit may be written for varying periods. It is closest to pure insurance, and as such it does not normally have a cash value. It has special appeal in that it can provide temporary protection when the personal income is too low to buy permanent, or when there are temporary needs for limited periods. It does not usually protect the insured beyond a certain age. The cost becomes increasingly high with age. When purchased at a young age, the cost is very low allowing other investments to be made from a limited income. It is a better buy than permanent for the individual who can accumulate enough capital so that he doesn't require the protection of insurance in his later years, or if his needs for insurance diminish with time.

- <u>Serviceman's Tendency to be Over Insured With the Wrong Type of Insurance</u>

The sinking of USS Thresher in 1963 caused a great deal of high level concern about the unhappy results of the poor and improper arrangement of personal affairs. The range of insurance for 16 officers was from $0-$45,000 with an average amount of $23,700; the range of enlisted was from $0-$35,000 with the average being $12,750. This is a relatively small sample size, but 11% of the officers and 22% of the enlisted had no insurance at all. In general, Thresher widows indicated that additional insurance coverage was needed and enlisted widows recommended that Navy men should be compelled to carry insurance and to make wills [Bailey, p. 4]. To a great extent, the financial hardships imposed on the widows were caused as much by the improper arrangement of personal affairs as by the amount of insurance coverage. Only 44% of the officers and 1% of the enlisted left valid wills. Whether caused by a lack of communications or understanding, there were several policies which the widows thought to be current that were not traceable. The companies, amounts, and policy numbers in question could not be determined from then existing personnel records. As a result some of the policies thought to be in force were never collected. This, in itself, caused the widows to receive somewhat less from insurance than they expected. In addition, there were cases where beneficiaries on the policies were not changed from parents to widows and children and many that left no wills so that some insurance

went to others rather than to the immediate survivors. There was also a percentage of invalid wills. In one case a will lacked a third witness and so was invalid in the state where probated. The widow was made guardian of all property, but she was required to appear in court prior to disposing of anything in the estate-even personal clothing /[Bailey, p. 4_/]. Also, three of the 16 officers were not married. These factors taken together would seem to indicate that the insurance coverage for the average officer family was actually somewhat higher than the $23,700 average listed. Particular family situations, such as parents having wealth or the amounts of money the officers had in investments are not known; therefore, it would be difficult to determine if coverage was sufficient. Whether or not it was enough the average actual amount paid to officer families was much higher than the amounts held by the average civilian family, and in addition these familes had the benefits of support from DIC. This is not an attempt to say that the insurance coverage for the Thresher families was sufficient. Certainly it was not if the average paid to widows and children of officers was something on the order of $30,000 and there was nothing else in the "kitty." Perhaps better than anything else this does demonstrate that the officer, at least, has significant advantages over the civilian which should allow him to be more liberal in pursuing his objectives in all his financial planning. Regretfully, there is no date on the

amount of term insurance coverage of personnel on the Thresher. It seems, from the amounts of coverage, that the individual insurance programs consisted primarily of permanent plans. If that supposition is correct, it is obvious that much greater amounts of insurance proceeds could have been provided if the amounts paid in permanent premiums had been applied to term coverage.

The loss of the Thresher focused attention on personal affairs and many improvements have been made since that time. Wills are now prepared by legal offices on request, service records are now more currently maintained by listing insurance companies, policy numbers, and other pertinent data and group term insurance (SGLI) is available to all members of the Armed Forces.

A study of 236 submarine officers from late 1965 through February 1966 revealed that the average insurance coverage for those of comparable ranks had almost doubled with the average being $42,220 and a range of $10,000 to $108,000 /Bailey, p. 39_/, which was significantly greater than the average civilian's coverage at that time. The bulk of the insurance coverage was permanent plan and responses showed that some of the officers were not carrying SGLI which was then available for about $2.00 per month for $10,000 of coverage /Bailey, p. 40_/. Apparently there is also a need to legislate certain matters in the military. In my opinion the cause of the present high percentage of participation in SGLI is more dependent on the fact that it is automatic (those

not desiring policy must fill out a form) than on the individuals making an ascertation of whether or not it was a good buy. Total coverage increased about $10,000 with progression up through the ranks with Captains holding $75,700 on the average [Bailey, p. 17]. Large percentages of the officers, especially Commanders and Captains, indicated that they used permanent plan insurance as a means of forced savings [Bailey, p. 20], and the majority had investments in Series E bonds, Credit Unions, Bank savings, and Savings and Loan Associations [Bailey, p. 27]. Combined with certain other results in the study it appears that while insurance coverages had been increased considerably, the overall ultra-conservative approach to the problem of accumulating capital or building an estate had not been altered. Also, based on the stepped increases in insurance with rank, it seems that the conservatism is more marked as the serviceman grows older. This may also indicate that the majority were caught short of capital in their estates, since there was such an increase in insurance within a three year period. Ideally, the requirement should diminish with age. This is only possible when the overall plan is well-conceived and commenced at an early age.

It must again be emphasized that while insurance is an excellent means of creating an estate, there is very little capital formation until the death of the insured. Therefore, the individual should not consider the face amounts of his policies as a part of his financial assets except for estate tax planning.

V. THE IMPACT OF FINANCIAL PROBLEMS ON THE MILITARY RETIREE

THE CRITICAL PERIOD

The serviceman who is approaching 20 years of service may be faced with several difficulties. This is a critical time in his life because he may choose to start a second career while he is still reasonable young. If he has planned wisely there is no particular problem. However, if he has not, he is apt to be presented with a number of needs requiring large capital expenditures while at the same time he is trying to adjust and become settled in civilian life. Those who go on to serve out a full 30 years have somewhat less of a problem even if their planning is insufficient because they can finance these heavy expenses from their active duty pay and then go on to retire with a much greater income even though there may be less industry demand for them because of age. However, many do retire with about 20 years of service. Statistics show that the average age at the time of retirement for officers and enlisted combined is a mere 41.5 years ["Where To Retire," May 1974]. Therefore, the majority of the military have to face this critical period and may are ill-prepared financially to do so. There are many officers in the 16-20 years of service bracket who have no savings or investments whatsoever. Others have waited until too long to start their programs or have planned inadequately so that all their disposable incomes are tied up in insurance and annuity

programs or "loaner" type investments. There is just not enough capital in such programs to finance the education of several children or to buy the kind of house that is needed. There are those in this 16-20 years of service bracket who are still borrowing money to buy new uniforms, when their net worth in assets and equities should be on the order of several hundred thousand dollars depending on the incomes earned in the military. No doubt many of these individuals are counting heavily on their anticipated earnings in civilian life to finance the heavy expenses, but the combined income from retirement and civilian employment may be insufficient if the family has not learned to limit its spending during 20 years of service in the military.

In a 1972 survey of the members of the Retired Officers Association, 16,000 responses were received. The majority (45.4%) were in the 50-59 year age group, and 31.0% were in the 60-69 year age group. Responses indicated that 34.1% were fully retired, 51.3% were fully employed, 8.0% were employed part-time, and 3.2% were seeking employment. The annual income of all the respondents from all sources, including joint income, was distributed as follows:

Under $5,000	$5,000- $10,000	$10,000- $15,000	$15,000- $20,000	$20,000- $25,000	$25,000- $30,000	Over $30,000
2.0%	14.4%	22.9%	19.1%	15.2%	8.1%	13.0%

/"A Report on the Membership Survey," June 1973, Capt. John M. Gore USN-Ret._7.

This distribution of income is not significantly different from that of the active duty officers, although it must be realized that about a third of the respondents were fully retired and that only 10.7% were from the 40-49 year age bracket. An argument might also be that those from the older age brackets don't care too much about the amounts of income they earn since they only work to keep occupied, but, of course, there is usually a great deal of bickering when increases in retirement pay are limited. Regardless of the amounts of marginal increases, it would seem evident that increases would be taken by the expenses of childrens education and housing in those cases where the planning is poor. If these heavy expenses have to be financed out of the marginal increase in income this precludes the individual from accumulating a capital base even during the period of highest earnings.

PLANNING FOR EDUCATION AND HOUSING COSTS

It is very difficult to make projections into the future as to the costs of education and housing. The serviceman needs at least to plan for the bulk of these expenses for if he can finance these, he will have resolved two major financial problems and fulfilled two important responsibilities. If he is able to do more. he is just that much better off. The cost of attending a good private American college was $6,000 in 1974 /"Inflation Hits College Cost," 5 April, 1974_7. If increases continue at the same rate as in the

past the cost could easily be $12,000 in 10 years. If there were three children, this might require as much as $144,000 to educate them starting 10 years hence if they attended only 4 years each. Granted, there are state schools, but even these costs will probably be running close to $6,000 by that time. State schools could come to around $72,000 in expenses for three children and one of these expenses include clothing, transportation, etc. If the children were properly separated in age so that only one was in college at a time this might ease the yearly burden, but the total impact of the costs cannot be avoided. Less provisions need to be made when there is only one child, but even then some planning is necessary.

Education can be enough of an expense by itself, but what if a house must be brought at this same time. If one has been a homeowner through the years, he can likely get into the home of his choice at minimum expense. However, if housing costs continue to rise as in the past the renter or "quarters taker" will be paying a very large amount for rent or a similar amount on the mortgage of an expensive house in the very near future. The problem is not one of planning exactly; the problem is getting those that need to plan to plan at all. If one has done a thorough job of planning he can use the return from investments to pay most of the yearly costs of education without decreasing his capital by a substantial amount, and he can use his equity from homes to purchase the retirement home. The whole point is that one

who plans out his particular situation, uses a realistic approach, maintains ownership of a house, and seeks out a good return on his investments can have reasonable expectations of meeting this type of financial objectives. The individual who doesn't own and who limits himself to a 6 to 8% maximum return objective before taxes and inflation will have a much more difficult time in getting through the critical years with any capital remaining.

EXAMPLES OF SERVICEMEN'S ABILITIES TO PLAN

I have known a number of enlisted men who approach their 20 year retirement thinking that their major financial responsibilities will decrease concurrent with their retirement and that any income earned from civilian employment will be extra. Some even think that they will not have to get a job. A typical comment might be "I'm just going to get a boat and motor and do a lot of fishing, and perhaps my wife and I will get in a lot of traveling in the motor home we're going to get." Usually about six months before retirement the same individual realizes that he is going to have to give up his quarters and starts shopping around for a house or a place to rent. The economy has left him far behind and he is in for the shock of his lifetime. A good percentage of his retirement pay is going to be spent for rent or monthly payments, let alone the other expenses of living such as food, clothing, utilities, or installment payments. If there is any capital at all, it may all be taken in the down payment for a house. Sometimes,

there is not enough for a down payment on a decent and comfortable home. If buying has been delayed to this inopportune time, perhaps a second mortgage will have to be taken out. The realization that he will have to get a job just to meet these expenses should not come as a big surprise, but it often does. The new retiree may have to plunge deeply into debt to acquire a house, he may not be able to do as much as he would like for his children, and perhaps he has come face-to-face with financial reality for the first time in his life. Not only can he not do those things on which he has counted all his life, but he must also get employment to maintain his existence. Often there is such desperation that both the serviceman and spouse get jobs to offset these unforeseen expenses and debts.

Now it would seem that an officer would be in a much better position. After all the officer is supposed to be a manager with some type of formal education who has been receiving perhaps twice the pay of the enlisted man. But what of the rising costs of higher education which is becoming more of a necessity, the standard of home the officer would like to have, or the "front-end" costs of starting his own business. If he has not planned for these expenses, he is going to have to take on a heavy indebtedness in order to maintain his standards and carry out his responsibilities. I have known a senior officer with almost 30 years of service who was perplexed about $75 of expenses for his change of command reception, and indecisive about whether he should pay

it, split it with his relief, or take the money out of the Welfare and Recreation Fund. The same officer had to draw advance travel pay to get to his last duty station. This was the final result of many long years of inadequate planning. This type of situation is more than neglect; it is a disgrace. Anyone who has to be so concerned with such trivial money matters cannot be mentally ready to perform to his full potential as a military officer. It is also a disgrace because such weakenesses can be covered up only so long. Eventually they must surface and this degree of financial difficulty becomes fairly common knowledge among subordinates. This causes the young officer or enlisted to wonder if an individual so inept at financial matters could be capable of managing anything else. It is not a good atmosphere or training ground for younger people.

On the other hand, there are those in the military that manage well. A good example of this is a friend of mine who built his estate entirely from his military income, ie. there were no inheritances, no businesses, no joint income from his wife. This individual retired after 30 years of service with a net worth exceeding $450,000 with the bulk of this capital in securities which he had started buying in small lots since the beginning of his career. During his career he became more sophiscated in making his investments in the stock market, but he rarely traded and never made a big "killing." He just kept "plugging away" systematically over a long period of time. His retirement home is not inexpensive,

but the mortgage is small because he had built up equity in several homes purchased over the years. He supported two children through good universities. Overall he has enjoyed just as good a standard of living as those who spent all their incomes. Since has has relatively low living expenses, low mortgage payments, and no outstanding debt, he has ample margin on his retirement income to enjoy a good standard of living and he still manages to save a portion of this pay for investments. He made some very basic and simple rules for himself at a very early age which he followed all through his career. He still has in his possession the original projection of his estate. It is strikingly similar to his actual estate at any point in time. Four hundred and fifty thousand dollars is certainly not the largest estate, but it is respectable. This accumulation was accomplished entirely on his military salary.

There are a few in the military who contend that one can only be a first class performer if he has almost complete disregard and disdain for personal finances. My personal conviction is that a small amount of time should be allowed for the financial aspects of a career also because common sense, application, and commitment to a sound financial program just don't take that much time. Some involvement in personal financial affairs does not detract from the professional aspects of a military career. In fact it may enhance it so that the individual can better serve his country, his family, and be a better representative of the military.

SUMMARY

At the present there is no conclusive data, but based on factual knowledge of a few situations and data on the general public there are likely a number of military retirees that have no source of income other than their retirement pay by the time they are fully retired or at the age of 65. If this supposition is correct then this indicates that fairly large amounts of their civilian incomes and whatever capital they accumulated during their military careers was expended during the critical period. The bulk of this capital could be retained. Retirement pay alone may be sufficient and it may be all the individual wants, but it is far short of the standards that could be enjoyed had he planned and consistently followed a sound financial program. Besides the better enjoyment of later life, the individual who has managed to accumulate some wealth by the time he reaches 20 years of service has a much greater freedom of choice in the available alternatives. He may elect to remain in the service, but he is not forced to continue for financial reasons. If he decides to retire, he has a much wider range of options.

VI. FINANCIAL PLANNING FOR THE SERVICEMAN AND PRINCIPLES THAT CAN BE EMPLOYED TO ACHIEVE OBJECTIVES AND GOALS

It has been previously pointed out that the two major financial hurdles that may confront the average serviceman are the education of his children and the furnishing of a home during retirement. These two items alone will require a large outlay of capital, but with some sound financial planning and execution at an early age the serviceman can meet these objectives. The overall plan must be to accumulate a large enough amount of capital so that the objectives may be financed from the return on the capital without decreasing the capital base, or at least minimizing that decrease.

For successful execution it is necessary that about 5 to 10% of the salary be saved and allocated exclusively for investments. The objective of accumulating a large sum from small monthly savings places stringent requirements on other elements of the plan. It is imperative that the investment program be carried out consistently over a long period of time. The objective also requires income planning so that major and necessary purchases can be made without depleting the investments. The purpose of this is two-fold. It reduces taxation, and it precludes the investor from having to liquidate a portion of his assets at an unfavorable time. Thus, the investment portion of the overall plan should be entirely separate from the other aspects; it should not be used for

any major purchases such as buying a car or even for buying a residence. In addition, the investments should be made in areas that offer good returns and so arranged that the bulk of the returns come as capital gains. The investor should again minimize taxation by taking the gains only when necessary to protect his position, and the gains must be reinvested to produce the greatest accumulation.

If the amount of capital accumulated is too small, then it may be totally depleted after a few years. Accumulating and retaining a good amount of capital and using only the returns to finance major objectives is the key. This fundamental plan sets an admittedly high financial goal within the constraints of the military salary. In order to attain this goal two important principles must be emphasized and used by the serviceman whenever possible. These are the principles of ownership and the formation or accumulation of capital over a long period of time in recognition of the time value of money. The security of the military salary makes it ideally suited for incorporation with the principles and overall plan, and rather surprising goals can be achieved. Of course the serviceman may set even higher financial goals. However, if he achieves the minimum goals specified here he will be able to meet all his responsibilities and obligations remaining free of financial difficulties.

THE PRINCIPLES OF OWNERSHIP

Some of the advantages of ownership have been previously discussed in connection with the personal ownership of a house.

As a minimum the serviceman should own his own home, and he should take full advantage of the principles of ownership in the majority of his other investments for many of the same advantages apply if he decides to funnel his savings into "owner" type investments. Real property ownership, in particular, offers special advantages and is perhaps the best example for demonstrating the principles of ownership.

LEVERAGE

There is nothing that offers greater leverage to the private investor than real property. In many cases property can be brought for a 25% down payment and sometimes for as little as 10% down. This gives the owner control over a relatively large amount of assets which he may eventually own altogether with a minimum of initial risk and commitment of his own capital. The creditor takes the majority of the risk and the owner may earn a higher rate of return on his investment than on the rate of return on the total assets.

Example:

Investor purchases $100,000 worth of property which produces an annual net income of 10% ($10,000). The investor puts $10,000 down on the property securing a $90,000 8% loan to be amortized in 30 years.

Net Income	$10,000
Less Mortgage Payment	7,925
Net Return to Investor before Taxes and Depreciation	$ 2,075

$$\frac{\$2,075}{\$10,000} = 20.75\%$$ Effective Rate of Return on Investment before Taxes and Depreciation

However, the investor may be inherently more interested in the appreciation of the property or in its future income producing potential than in the present income. For the time being, he may be somewhat content with less income returns while he is upgrading the property through improvements. In effect, those renting the property are building his real equity and in addition he stands to gain the entire amount that the property appreciates. In the long term his mortgage will be paid for him and he will get all the increases in the market value of the property. He may sell the property at a time of his own choosing when it is most advantageous, he may trade the property maintaining his equity, or he may retain it as a major source of income in the future.

TAX ADVANTAGES

During the course of ownership some important tax advantages also accrue to the owner. He can depreciate the property and he can deduct the amount paid for interest on the mortgage. Both are attractive tax savings devices, and both are a means of protecting other income earned.

Example:

As an example, compare the owner of the same $100,000 worth of property during the first year with an investor earning the same amount of return from capital in a savings account. The assumptions are that both individuals are married tax payers filing jointly and that all other conditions

are such that both have adjusted gross incomes of $25,000. No other deductions on exemptions are considered, except that the owner has deductions for depreciation and interest expense.

Owner

Cash Investment		$10,000
Net Income		$10,000
Less Mort. Payment		7,925
		$ 2,075
Adj. Gross Income		$25,000
Deductions:		
Depreciation	$3,333	
Int. Exp.	7,200	
	$10,533	$10,533
Taxable Income		$14,467
Income Taxes		2,877
Income After Taxes		$22,123
Tax Savings	$3,143	

Savings Account Investor

Cash Investment	$25,940
Annual Interest Rate	8%
Net Return	$ 2,075
Adj. Gross Income	$25,000
Taxable Income	$25,000
Income Taxes	6,020
Income After Taxes	$18,980

Through a cash investment of $10,000 the owner obtained an additional $10,533 worth of deductions in the first year of ownership although the least advantageous type of depreciation, straight line, is used. This gave him a tax savings of $3,143 in comparison with the "loaner" investor who did not have the benefit of these deductions. In this hypothetical case the tax savings is greater than the net return from the savings account. The "loaner" investor had over two and one half times that amount of capital committed, and the net returns on investments are the same. Yet, the owner protected his $25,000 and retained $3,143 more than the savings account investor. Inflation will have a direct effect on the

purchasing power of the $25,940 in the savings account, but the owner will feel less of an effect because the rents he may demand may increase and the dollar value of the property should increase.

DISPOSITION OF PROPERTY

The most significant advantages may occur when the owner disposes of the property. In an outright sale, as with other investments, he can treat the net gains as long term capital gains, thereby excluding half the gains from all taxes provided that he has held the property for a period of at least six months. When real property is sold the owner may also elect to take only 30% of the total sale price in the first year and the remainder in the following year as an installment sale (sometimes called the 29% rule). If the owner wants to trade down to a lesser "like" property he only pays long term capital gains taxes on the difference in the trade or on the amount of mortgage relief. If the "like" properties are of the same value, they may be exchanged "tax free." But if the real property owner always trades "up" for "like" property he can build up a considerable equity without ever having to pay taxes on the appreciation of the property. Such an owner can accumulate a large amount of assets without ever showing gains which is an advantage offered by no other form of investment. Meanwhile any income earned is protected by deductions for depreciation, interest expense, and improvements which add to the material value. Owners of securities are sometimes forced to taking profits to protect positions when the market

turns "sour." At such times capital gains are taken from their holdings. The real property owner may never be forced into this situation. He can defer the gain almost indefinitely.

THE TIME VALUE OF MONEY

The other basic principle that must be applied to investments by the serviceman is the recognition of the time value of money and the significance of a few percentage points in accumulating capital. One of the most dramatic illustrations of the way money grows over a long period of time is the example of a small amount, $5,000, Benjamin Franklin gave to the residents of Boston in 1791. Although his proviso that it be allowed to accumulate compound interest for 200 years was violated in 1891 when $322,000 was withdrawn, the fund exceeded $17,000,000 in 1961 or 170 years after the initial deposit [Newman, p. 30]. Obviously we don't have as much time as Franklin's deposit, but we can still put the principle to work for ourselves. In fact we have the advantage of living in an era when the rates of return are much better than in Franklin's day and we can add small amounts periodically. For example with any kind of budgeting whatsoever a serviceman can save 5-10% of his salary. This is a fairly reasonable amount and should not be too difficult for most. Indeed that amount can be taken from most military incomes without having to decrease the standards of living. If it did cut into the standard then it would just about equal a new car payment. So the individual must then decide if he would

prefer a new car or financial security. Five to ten per cent still seems a rather small amount, but then if one put only $1,000 per year into an investment earning 15% compounded annually, the investment would be worth $1,013,346.00 in 35 years assuming that all returns are reinvested and that income from other sources was used to pay taxes [Newman, p. 90]. If the investment earned 20% or 25% it would be worth $3,537,995 and $12,320,920 respectively in the same period of time. At first glance these rates of return might seem unreasonably high, but many investors expect them. It is no more ridiculous to think that these rates can be earned than it is to think that an investor paying taxes in the 25% bracket with money deposited in a savings account earning 6% in a period of 4% inflation is maintaining his purchasing power. At the same time a wise investor can arrange his investments to reduce the tax-bite to a reasonable level so that it is not as awesome as it first appears.

TAX SHELTERS

Another area which must be examined is taxes. We have heard so much about tax-shelters and how important they are that we are convinced that an investment labeled "tax-sheltered" is enviable regardless of the rate of return when in most cases we should be concerned with getting a few extra percentage points on the investment. As an example if one had $160,000 invested and yielding a 25% gain and all his gains were long term, he would get a $40,000 return per year on

which he would pay $4,380 in income taxes assuming a married taxpayer filing jointly with no other deductions, exemptions, or income considered. Four thousand, three hundred and eighty dollars ($4,380) in taxes constitutes about 10.9% of the total $40,000 return. (Oddly enough the $8,000 per year wage earner who has the unreasonable amount of $7,000 worth of deductions leaving only $1,000 of taxable income is paying taxes at the rate of about 15%.) If the investor's return were cut to 9% on the $160,000 of capital he would receive $14,400 of which $1,228 would be payable in taxes leaving $13,172. He is still better off than one with $160,000 invested in tax exempt municipal bonds paying at 8% or $12,800 annually. Thus the 1% difference between the rates of return offsets the effect of taxes when the investor can take long term capital gains. In certain types of investments the capital gains can be deferred for fairly long periods of time so that the capital gains taxes only have to be paid once during the entire period. There are no capital gains taxes on paper profits; the taxes are only charged when the paper profits are converted into actual gains.

Tax shelters are excellent, we should use them whenever we can, but we must avoid being duped by them. Life insurance programs and annuity programs are excellent tax shelters, but they don't pay enough of a return for capital formation in substantial quantities and, as such, they are very poor forms of investment and poor hedges against inflation. As long as an extra percentage point can be gained, that is probably the

best direction to take when most of the profits may be taken as long term capital gains, and this holds true until a very highly taxed income bracket is reached. Thus taxes on some forms of personal investments may take only about 10% of the total return which points out that inflation is by far the greatest enemy of the investor since it affects the entire capital base. If the inflation rate is 6% for instance, a 6% return is required to offset the effects of inflation alone. In some forms of investments it is impossible to take all returns as long term gains, but one should work to organize his investments so that this advantage may be maximized. One thing is for certain, if one's capital is totally committed to savings accounts he cannot have long term capital gains, he is totally exposed to the effects of inflation, he will pay a maximum of taxes for his income bracket, and he will pay it every year on the first dollar of interest earned.

INVESTMENT OPPORTUNITIES FOR THE SERVICEMAN

The average price of farmland has doubled within the past ten years [Newman, p. 58]. This is nothing spectacular since it is growing at about 8% compounded annually. But there is also an opportunity for income along with the tax advantages if offers. In a great many areas the price has tripled or quadrupled in the same time period. Land is obviously a very good investment. It gives the investor leverage, an opportunity for tax savings, and thus a protected income while assets are being accumulated. One may also gain these advantages in

buying houses, real property, or parcels in planned community developments. Investments in this sort of property requires some knowledge and gains are dependent on selection, location, and the intrinsic value; but gaining that knowledge is not an insurmountable task nor is the management too time consuming. A great many of these types of investments have been yielding from 15-50% over the last several years. Commercial property also offers great potential for gains, but "inside information is often necessary for a quick turnover and this may be difficult if not impossible for the serviceman to obtain.

The stock market which has recently experienced difficulties generally protects the investor against inflation while offering good potential with some leverage. On the whole it has set some rather impressive gains in the "long-pull." According to statistics the combined annual return from dividends and capital appreciation on all common stocks in the 20 year period up to 1972 averaged 14.3%. The averaged combined yield has been even higher in certain fields. The average gain for electronics stocks over the same period has been 18.4% and the average gain of office equipment stocks has been 22.7% [Newman, p. 91]. The top 25 mutual funds increased in appreciation alone at rates between 15-36% from 1958 to 1968. If one had invested in the average of stocks which comprise the Dow Jones Industrials in 1948, and held the stocks until 1968 (a period of generally rising prices), he would have gained 12% annually and all of these companies are very large and not necessarily

dynamic. To be more explicit, a $10,000 investment in the average of these industrials in 1948 was worth $100,000 in 1968 [Springer, p. 174].

Individual stocks have scored much more impressive gains in short periods. Thane Plastic Corp. gained over 2800% in 1967, Wong Inc. gained 800%, and Shares of Aero Systems, Inc. gained over 2200% [Springer, p. 126]. Admittedly these are spectacular gains and they were made when the public was buying feverishly, but there are hosts of other stocks that have had gains of several hundred percent in a year's time. Even with the depressed market of recent times, a fairly experienced investor can take advantage of the range in stock prices which cycle about 20-30% in price yearly. A depressed market limits the investor substantially because he is constrained by the timing problem. He must often sell within a short period of time to protect his capital position. In a depressed market situation the investor has to adjust his methods of operation to the times, else he has to ride out the lows with his holdings or sustain heavy losses if he has held on for too long. While they often forego long term gains, some traders have temperaments and are better suited to declining market situations than to rising prices. Yet one who lacks skills or the personality for timing his trades and one who doesn't want to become so involved in the market trading can select several stocks by the "dart board" method and he will get a good return over a period of many years.

To look at the records of some stock market investors, a recent survey of the National Association of Investment Clubs, which has about 800,000 members showed that 96% of the clubs were profitable, that 13% of the clubs averaged earnings of more than 25% annually, and that the average annual earnings were 16%. The oldest club had averaged 15.4% annually since being founded and the best club (only a few years old) posted a 241% annual gain record. The average man just passed the average woman with a 15.59% to 14.64% return and a large number of the clubs expected a 20% annual return [Newman, p. 102].

It should be kept in mind that a great number of people do not possess the psychological make-up or skills to get ahead in market trading, especially in a generally declining market. Almost 85% of all people lose money during their first year in the stock market. However, over a long period of time the market has proven itself even for the methodical investor who consistently invests on a periodic basis. If one chooses the market as his means of investing, he must first know enough about himself so that he can select the approach that is best suited for him. Either of the two approaches may be taken, but they must be suited to the personality because there is nothing that can be more damaging to one's financial endeavors than to have a mismatch between his personality and the methods employed. One basic approach is the more gradual accumulation of capital over a long period of time. It is largely dependent on faith in the economy and a degree of

stubborness which enables the investor to buy through the lows because of beliefs that the stock will eventually rise. The other approach is almost purely technical. The distant future has little bearing; it is what is actually happening at the time. In this case the investor has little concern for the intrinsic value of a stock; it may be a good "buy" and it may be underpriced, but it is not attractive until it starts to move. The same philosophy is employed if the stock starts down, because this investor would usually react by selling, taking the minimum loss. It makes little difference why the price is falling; the mere fact that it is, is good enough reason to get out. The trader cannot afford to ride out the low. This time is valuable since there might be an opportunity loss in another issue. In buying the trader needs "inside" information, but once the stock is acquired this "inside" or near perfect information is practically useless to him although he should take full measure to minimize his risks.

If the serviceman decides that he would like to take the latter approach, there are several excellent sources of knowledge that will help to prepare him. If there is some doubt on his part, it would be prudent that he starts out with a few hundred dollars and perhaps take the losses most likely to be incurred in the early stages. In this manner he may learn very inexpensively that regardless of how well-informed the investor is, it is his own personality which causes him to behave in certain patterns which may be detrimental. If he finds himself unsuited for this approach, he may then

resort to routinely investing on a periodic basis. Whether or not the serviceman can adjust to the techniques of the trader is somewhat immaterial. By systematically investing he still stands the chance of benefiting from the vast potential of the market.

DISCUSSION OF DOLLAR-COST AVERAGING

There are many types of formula plans for investing in the stock market such as Constant Dollar Funding, Equalizing Plans, Variable Ratio Plans, etc. For the military investor who wants to invest systematically there is nothing better suited than the dollar-cost-averaging plan. The plan is simple and it requires little investor knowledge. The plan requires investing certain amounts at regular time intervals over a long time period so that in effect the majority of the shares are purchased at below average market prices. The plan requires ample perservance for the investor tends to become discouraged in market fluctuations when prices are down when he should be content in buying the shares at the lower prices.

The plan incorporates many of the necessary principles such as the time value of money, making investments periodically over a long period of time, it defers most of the capital gains during the time that the shares are being purchased, and it takes advantage of the potential of the market while it greatly reduces the risk of buying shares at high prices. Other advantages are that the commissions may be reduced substantially by buying through the monthly investment plans

presently offered by many of the corporations, and fractional shares may also be purchased. As with other types of investments, stocks may be bought for a child under the Uniform Gift to Minors Act so that the dividends are protected from taxation until the gross income amounts to $750 annually.

The investor should select a good, strong, viable company that is expected to maintain its position in the industry. He cannot be totally ignorant of the market. He must follow his stock and the market to some extent to ensure that "downs" are due to fluctuations and not to the company's becoming obsolescent or being improperly managed. The investor cannot afford to be left with a stock in a company that has collapsed in bankruptcy or one that is operating in a declining industry. However, the wider and deeper the swings the better the gains as long as the company eventually recovers from the down. The investor's position may also be enhanced if he can invest alternately in two or more stocks that are somewhat out of phase in their cyclic fluctuations. Dollar-cost-averaging may be used in both stocks or in buying mutual funds. In general, there are extra costs involved in mutual funds and the fluctuations are not so wide because of the wide diversification. The primary advantage of dollar-cost-averaging is that it eliminates the major concern and risk of the investor-that of buying the bulk of the shares at high prices.

EXAMPLE OF DOLLAR COST AVERAGING

In the following example of dollar-cost averaging $2.00 per day is saved and invested at the end of each quarter in a company whose "swings" follow the trend of the general market. The company selected is not an exceptional performer and actual market prices are used throughout a 28 year period commencing in 1933. Shares are brought at the mid point of the range in price at the end of the quarter or on the next day when the stock was traded. In all but 11 cases, an odd-lot fee of 12½¢ (cents) per share is charged. Money remaining after the purchases is carried forward to the end of the next quarter.

Purchase Date	Funds Carried Over	Amount Accumulated For Investment	Total Amount Available For Investment	Round-Lot Cost Price Of Shares	Odd-Lot Cost Price Of Shares	Number Of Shares Just Bought	Cumulative Total Of Shares Held	Cost Of Shares Just Bought	Cumulative Cost To Date	Uninvested Remainder	Current Liquidation Value of Entire Portfolio
3/1/34	--	$180.00	$180.00		5-1/4 + 1/8: 5-3/8	33	33	$ 177.38	$ 177.38	$ 2.62	$ 169.13
6/1/34	$ 2.62	184.00	186.62		4-3/8 + 1/8: 4-1/2	41	74	184.50	361.88	2.12	314.50
9/1/34	2.12	184.00	186.12		4-3/4 + 1/8: 4-7/8	38	112	185.25	547.13	0.87	530.50
12/1/34	0.87	182.00	182.87		3-5/8 + 1/8: 3-3/4	48	160	180.00	727.13	2.87	572.50
3/1/35	2.87	180.00	182.87		3 + 1/8: 3-1/8	58	218	181.25	908.38	1.62	651.75
6/1/35	1.62	184.00	185.62		3-3/8 + 1/8: 3-1/2	53	271	185.50	1,093.88	0.12	905.75
9/3/35	0.12	188.00	188.12		5-1/2 + 1/8: 5-5/8	33	304	185.63	1,279.51	2.49	1,671.15
12/2/35	2.49	180.00	182.49		7-1/4 + 1/8: 7-3/8	24	328	177.00	1,456.51	5.49	2,374.50
3/2/36	5.49	182.00	187.49		11 + 1/8: 11-1/8	16	344	178.00	1,634.51	9.49	3,778.50
6/1/36	9.49	182.00	191.49		8-1/4 + 1/8: 8-3/8	22	366	184.25	1,818.76	7.24	3,011.25
9/1/36	7.24	184.00	191.24		9-3/4 + 1/8: 9-7/8	19	385	187.63	2,006.39	3.61	3,743.13
12/1/36	3.61	182.00	185.61		9-7/8 + 1/8: 10	18	403	180.00	2,186.39	5.61	4,029.25
3/1/37	5.61	180.00	185.61		9-1/4 + 1/8: 9-3/8	19	422	178.13	2,364.52	7.48	3,900.75
6/1/37	7.48	184.00	191.48		8-1/4 + 1/8: 8-3/8	22	444	184.25	2,548.77	7.23	3,657.50
9/1/37	7.23	184.00	191.23		7-5/8 + 1/8: 7-3/4	24	468	186.00	2,734.77	5.23	3,560.00
12/1/37	5.23	182.00	187.23		4-1/8 + 1/8: 4-1/4	44	512	187.00	2,921.77	0.23	2,110.50
3/1/38	0.23	180.00	180.23		3-3/4 + 1/8: 3-7/8	46	558	178.25	3,100.02	1.98	2,085.25
6/1/38	1.98	184.00	195.98		3 + 1/8: 3-1/8	62	620	193.75	3,293.77	2.23	1,857.50
9/1/38	2.23	184.00	186.23		3-7/8 + 1/8: 4	46	666	184.00	3,477.77	2.23	2,572.50
12/1/38	2.23	182.00	184.23		3-3/4 + 1/8: 3-7/8	47	713	182.13	3,659,90	2.10	2,672.13
3/1/39	2.10	180.00	182.10		3-1/8 + 1/8: 3-1/4	56	769	182.00	3,841.90	0.10	2,394.50
6/1/39	0.10	184.00	184.10		2-3/8 + 1/8: 2-1/2	73	842	182.50	4,024.40	1.60	1,994.50
9/1/39	1.60	184.00	185.60		2-3/4 + 1/8: 2-7/8	64	902	184.00	4,208.40	1.60	2,490.75
12/1/39	1.60	182.00	183.60		2-5/8 + 1/8: 2-3/4	66	972	181.50	4,389.90	2.10	2,542.50
3/1/40	2.10	182.00	184.10		2-3/8 + 1/8: 2-1/2	73	1,045	182.50	4,572.40	1.60	2,476.25
6/1/40	1.60	184.00	185.60	1-1/2	1-1/2 + 1/8: 1-5/8	121	1,166	184.13	4,756.53	1.47	1,740.75
9/3/40	1.47	188.00	189.47	1-5/8	1-5/8 + 1/8: 1-3/4	115	1,281	188.75	4,945.28	0.72	2,071.50
12/2/40	0.72	180.00	180.72	1-3/4	1-3/4 + 1/8: 1-7/8	103	1,384	180.63	5,125.91	0.09	2,411.50
3/3/41	0.09	180.00	180.09	1-3/8	1-3/8 + 1/8: 1-1/2	128	1,512	179.50	5,305.41	0.59	2,077.50
6/2/41	0.59	182.00	182.59	1-1/8	1-1/8 + 1/8: 1-1/4	156	1,668	182.50	5,487.91	0.09	1,868.00
9/2/41	0.09	184.00	184.09	1-3/8	1-3/8 + 1/8: 1-1/2	131	1,799	184.00	5,671.91	0.09	2,461.25
12/1/41	0.09	180.00	180.09	15/16	15/16 + 1/8: 1-1/16	181	1,980	179.81	5,851.72	0.28	1,862.25

Purchase Date	Funds Carried Over	Amount Accumulated For Investment	Total Amount Available For Investment	Round-Lot Cost Price Of Shares	Odd-Lot Cost Price Of Shares	Number Of Shares Just Bought	Cumulative Total Of Shares Held	Cost Of Shares Just Bought	Cumulative Cost To Date	Uninvested Remainder	Current Liquidation Value of Entire Portfolio
3/3/42	$ 0.28	$184.00	$184.28	7/8	7/8 + 1/8: 1	209	2,189	$184.00	$ 6,035.72	$ 0.28	$ 1,904.25
6/1/42	0.28	180.00	180.28	15/16	15/16 + 1/8: 1-1/16	181	2,370	179.81	6,215.53	0.47	2,213.13
9/2/42	0.47	186.00	186.47	1-	1 + 1/8: 1-1/8	176	2,546	185.50	6,401.03	0.97	2,540.25
12/1/42	0.97	180.00	180.97	1-3/4	1-3/4 + 1/8: 1-7/8	103	2,649	180.63	6,581.66	0.34	4,629.63
3/1/43	0.34	180.00	180.34		3-1/4 + 1/8: 3-3/8	53	2,702	178.88	6,760.54	1.46	8,781.25
6/1/43	1.46	184.00	185.46		4-1/4 + 1/8: 4-3/8	42	2,744	183.75	6,944.29	1.71	11,656.50
9/1/43	1.71	184.00	185.71		3-1/2 + 1/8: 3-5/8	51	2,795	184.88	7,129.17	0.83	9,770.63
12/1/43	0.83	182.00	182.83		3 + 1/8: 3-1/8	58	2,853	181.25	7,310.42	1.58	8,909.00
3/1/44	1.58	182.00	183.58		3-1/2 + 1/8: 3-5/8	50	2,903	181.25	7,491.67	2.33	10,160.13
6/1/44	2.33	184.00	186.33		4-1/8 + 1/8: 4-1/4	43	2,946	182.75	7,674.42	3.58	12,146.50
9/1/44	3.58	184.00	187.58		4-5/8 + 1/8: 4-3/4	39	2,985	185.25	7,859.67	2.33	13,795.00
12/1/44	2.33	182.00	184.33		4-1/4 + 1/8: 4-3/8	42	3,027	183.75	8,043.42	0.58	12,868.13
3/1/45	0.58	180.00	180.58		7 + 1/8: 7-1/8	25	3,052	178.13	8,221.55	2.45	21,357.50
6/1/45	2.45	184.00	186.45		6-5/8 + 1/8: 6-3/4	27	3,079	182.25	8,403.88	4.20	20,388.50
9/4/45	4.20	190.00	194.20		7 + 1/8: 7-1/8	27	3,106	192.38	8,596.26	1.82	21,741.25
12/1/45	1.82	176.00	177.82		10-1/2 + 1/8: 10-5/8	16	3,122	170.00	8,766.26	7.82	32,778.25
3/1/46	7.82	182.00	189.92		9-7/8 + 1/8: 10	18	3,140	180.00	8,946.26	9.82	31,002.50
6/3/46	9.82	188.00	197.82		11-5/8 + 1/8: 11-3/4	16	3,156	188.00	9,134.26	9.82	36,681.50
9/3/46	9.82	184.00	193.82		7-5/8 + 1/8: 7-3/4	25	3,181	193.75	9,330.01	0.07	24,245.00
12/2/46	0.07	180.00	180.07		7 + 1/8: 7-1/8	25	3,206	178.13	9,508.14	1.94	22,441.25
3/1/47	1.94	178.00	179.94		6-3/4 + 1/8: 6-7/8	26	3,232	178.75	9,686.89	1.19	21,812.00
6/2/47	1.19	186.00	187.19		6 + 1/8: 6-1/8	30	3,262	183.75	9,870.64	3.44	19,564.25
9/2/47	3.44	184.00	187.44		6-5/8 + 1/8: 6-3/4	27	3,289	182.25	10,052.89	5.19	21,778.50
12/1/47	5.19	180.00	185.19		6-5/8 + 1/8: 6-3/4	27	3,316	182.25	10,235.14	2.94	21,966.50
3/1/48	2.94	182.00	184.94		5-1/2 + 1/8: 5-5/8	32	3,348	180.00	10,415.14	4.94	18,408.00
6/1/48	4.94	184.00	188.94		9-3/4 + 1/8: 9-7/8	19	3,367	187.63	10,602.77	1.31	32,819.88
9/1/48	1.31	184.00	185.31		9 + 1/8: 9-1/8	20	3,387	182.50	10,785.27	2.81	30,472.13
12/1/48	2.81	182.00	184.81		7-1/8 + 1/8: 7-1/4	25	3,412	181.25	10,966.52	3.56	24,309.00
3/1/49	3.56	182.00	185.56		6-5/8 + 1/8: 6-3/4	27	3,439	182.25	11,148.77	3.31	22,778.50
6/1/49	3.31	184.00	187.31		6-7/8 + 1/8: 7	26	3,465	182.00	11,330.77	5.31	23,813.75
9/1/49	5.31	184.00	189.31		7-7/8 + 1/8: 8	23	3,488	184.00	11,514.77	5.31	27,457.00
12/1/49	5.31	182.00	187.31		8-3/4 + 1/8: 8-7/8	21	3,509	186.38	11,701.15	0.93	30,702.63

Purchase Date	Funds Carried Over	Amount Accumulated For Investment	Total Amount Available For Investment	Round-Lot Cost Price Of Shares	Odd-Lot Cost Price Of Shares	Number Of Shares Just Bought	Cumulative Total Of Shares Held	Cost Of Shares Just Bought	Cumulative Cost To Date	Uninvested Remainder	Current Liquidation Value of Entire Portfolio
3/1/50	$ 0.93	$180.00	$180.93		9-1/2 + 1/8: 9-5/8	18	3,527	$ 173.25	$11,874.40	$ 7.68	$33,503.13
6/1/50	7.68	184.00	191.68		10-3/4 + 1/8: 10-7/8	17	3,544	184.88	12,059.28	6.80	38,092.50
9/1/50	6.80	184.00	190.80		9-3/8 + 1/8: 9-1/2	20	3,564	190.00	12,249.28	0.80	33,404.50
12/1/50	0.80	182.00	182.80		10-5/8 + 1/8: 10-3/4	17	3,581	182.75	12,432.03	0.05	38,038.00
3/1/51	0.05	180.00	180.05		11-3/8 + 1/8: 11-1/2	15	3,596	172.50	12,604.53	7.55	40,892.50
6/1/51	7.55	184.00	191.55		11-3/4 + 1/8: 11-7/8	16	3,612	190.00	12,794.53	1.55	42,439.50
9/4/51	1.55	190.00	191.55		14-1/4 + 1/8: 14-3/8	13	3,625	186.88	12,981.41	4.67	51,653.13
12/1/51	4.67	176.00	180.67		14-1/8 + 1/8: 14-1/4	12	3,637	171.00	13,152.41	9.67	51,368.00
3/1/52	9.67	182.00	191.67		14 + 1/8: 14-1/8	13	3,650	183.63	13,336.04	8.04	51,093.75
6/2/52	8.04	186.00	194.04		14-3/8 + 1/8: 14-1/2	13	3,663	188.50	13,524.54	5.54	52,647.75
9/2/52	5.54	184.00	189.54		16-3/8 + 1/8: 16-1/2	11	3,674	181.50	13,706.04	8.04	60,152.50
12/1/52	8.04	180.00	188.04		17-1/2 + 1/8: 17-5/8	10	3,684	176.25	13,882.29	11.79	64,459.50
3/2/53	11.79	182.00	193.79		16-3/4 + 1/8: 16-7/8	11	3,695	185.63	14,067.92	8.16	61,879.38
6/1/53	8.16	182.00	190.16		15-1/2 + 1/8: 15-5/8	12	3,707	187.50	14,255.42	2.66	57,457.63
9/1/53	2.66	184.00	186.66		14-1/4 + 1/8: 14-3/8	12	3,719	172.50	14,427.92	14.16	52,993.38
12/1/53	14.16	182.00	196.16		16-1/8 + 1/8: 16-1/4	12	3,731	195.00	14,622.92	1.16	60,158.50
3/1/54	1.16	180.00	181.16		17-5/8 + 1/8: 17-3/4	10	3,741	177.50	14,800.42	3.66	65,930.00
6/1/54	3.66	184.00	187.66		21-1/2 + 1/8: 21-5/8	8	3,749	173.00	14,973.42	14.66	80,597.38
9/1/54	14.66	184.00	198.66		21-1/2 + 1/8: 21-5/8	9	3,758	194.63	15,168.05	4.03	80,789.75
12/1/54	4.03	182.00	186.03		24-1/2 + 1/8: 24-5/8	7	3,765	172.38	15,340.43	13.65	92,234.38
3/1/55	13.65	180.00	193.65		26-1/4 + 1/8: 26-3/8	7	3,772	184.63	15,525.06	9.02	99,006.00
6/1/55	9.02	184.00	193.02		26-1/4 + 1/8: 26-3/8	7	3,779	184.63	15,709.69	8.39	99,188.88
9/1/55	8.39	184.00	192.39		27-5/8 + 1/8: 27-3/4	6	3,785	166.50	15,876.19	25.89	104,550.00
12/1/55	25.89	182.00	207.89		26-5/8 + 1/8: 26-3/4	7	3,792	187.25	16,063.44	20.64	100,950.50
3/1/56	20.64	182.00	202.64		26-5/8 + 1/8: 26-3/4	7	3,799	187.25	16,250.69	15.39	101,136.00
6/1/56	15.39	184.00	199.39		26-3/8 + 1/8: 26-1/2	7	3,806	185.50	16,436.19	13.89	100,382.50
9/4/56	13.89	190.00	203.89		27-3/8 + 1/8: 27-1/2	7	3,813	192.50	16,628.69	11.39	104,379.25
12/3/56	11.39	180.00	191.39		27 + 1/8: 27-1/8	7	3,820	189.88	16,818.57	1.51	103,137.50

Purchase Date	Funds Carried Over	Amount Accumulated For Investment	Total Amount Available For Investment	Round-Lot Cost Price Of Shares	Odd-Lot Cost Price Of Shares	Number Of Shares Just Bought	Cumulative Total Of Shares Held	Cost Of Shares Just Bought	Cumulative Cost To Date	Uninvested Remainder	Current Liquidation Value of Entire Portfolio
3/1/57	$ 1.51	$176.00	$177.51		28-1/4 + 1/8: 28-3/8	6	3,826	$ 170.25	$16,988.82	$ 7.26	$108,081.25
6/3/57	7.26	188.00	195.26		32-7/8 + 1/8: 33	5	3,831	165.00	17,153.82	30.26	125,940.25
9/3/57	30.26	184.00	214.26		30-3/8 + 1/8: 30-1/2	7	3,838	213.50	17,367.32	.76	116,574.50
12/2/57	.76	180.00	180.76		29-3/4 + 1/8: 29-7/8	6	3,844	179.25	17,546.57	1.51	114,353.50
3/3/58	1.51	182.00	183.51		30-1/4 + 1/8: 30-3/8	6	3,850	182.25	17,728.82	1.26	116,456.25
6/2/58	1.26	182.00	183.26		35 + 1/8: 35-1/8	5	3,855	175.63	17,904.45	7.63	134,918.13
9/2/58	7.63	184.00	191.63		37-3/8 + 1/8: 37-1/2	5	3,860	187.50	18,091.95	4.13	144,260.00
12/1/58	4.13	180.00	184.13		40 + 1/4: 40-1/4	4	3,864	161.00	18,252.95	23.13	154,544.00
3/2/59	23.13	182.00	205.13		42-1/4 + 1/4: 42-1/2	4	3,868	170.00	18,422.95	35.13	163,406.00
6/1/59	35.13	182.00	217.13		40-1/4 + 1/4: 40-1/2	5	3,873	202.50	18,625.45	14.63	155,870.00
9/1/59	14.63	184.00	198.63		40-1/2 + 1/4: 40-3/4	4	3,877	163.00	18,788.45	35.63	156,999.25
12/1/59	35.63	182.00	217.63		38 + 1/8: 38-1/8	5	3,882	190.63	18,979.08	27.00	147,505.75
3/1/60	27.00	182.00	209.00		35-7/8 + 1/8: 36	5	3,887	180.00	19,159.08	29.00	139,435.25
6/1/60	29.00	184.00	213.00		34-1/2 + 1/8: 34-5/8	6	3,893	207.75	19,366.83	5.25	134,296.88
9/1/60	5.25	184.00	189.25		36-5/8 + 1/8: 36-3/4	5	3,898	183.75	19,550.58	5.50	142,752.00
12/1/60	5.50	182.00	187.50		36-3/8 + 1/8: 36-1/2	5	3,903	182.50	19,733.08	5.00	141,971.25
3/1/61	5.00	180.00	185.00		42-1/8 + 1/4: 42-3/8	4	3,907	169.50	19,902.58	15.50	164,580.63
6/1/61	15.50	184.00	199.50		42-1/2 + 1/4: 42-3/4	4	3,911	171.00	20,073.58	28.50	166,214.75
9/1/61	28.50	184.00	212.50		48-3/8 + 1/4: 48-5/8	4	3,915	194.50	20,268.08	18.00	189,384.38
12/1/61	18.00	182.00	200.00		51-1/4 + 1/4: 51-1/2	3	3,918	154.50	20,422.58	45.50	200,793.00

Value of 3900 shares @ $51\frac{1}{4}$	\$199,875.00
Value of 18 odd lot shares @ 51	918.00
	\$200,793.00
Dividends Paid	76,839.50
Total Value	\$277,632.50

Broker's commissions have been omitted, but these would have increased the investor's costs by only about 5%. It should be noted that the maximum cost to the investor was at the end of the period when he had a total of \$20,377.08 invested. Without having reinvested the dividends, the investor had an appreciation of about 885% on his total cost of \$20,377.08. The average cost per share to the investor is \$20,377.08/3918 equaling about \$5.20 per share whereas the average price per share was \$14.43.

It must be emphasized that such a plan requires perseverance and systematic investing. It should also be noticed in the example that the stock slumped shortly after the program was started and that it was about 9 years before the investor started breaking even with his own costs. There were several times in years 6, 7, and 8 that there was a "paper loss" of about 7 out of each 10 dollars invested. However, these are the years in which relatively large quantities of shares were purchased. Another caution is that the "averager" must not be forced into selling at inopportune times. He must be willing to wait out the bad times and he must not be dependent on his investment as a source of capital, else he might be forced to liquidate his holdings at times when he would incur heavy losses. However, if the investor can meet these requirements he stands to benefit handsomely from his efforts.

The purpose of the foregoing has not necessarily been to make recommendations as to the types of investments that the serviceman should undertake in his program. Both real estate and the stock market are suitable in that they offer potential and they don't require an excessive amount of time. However, there are other investments which may fit the personal needs better. The purpose has been to demonstrate the goals that can be attained with "owner" type investments, and it is also an attempt to develop interest in this type of investments. The possibilities and potential cannot be overlooked. The serviceman needs to earn the greatest percentage possible on his investments and he needs protection from taxes and inflation whenever possible. "Owner" type investments offer those opportunities.

VII. FUNDAMENTAL LAWS RELATING TO ESTATE PLANNING

There are certain basic laws with which the serviceman should be familiar in planning his estate, for these laws can have a very difficult impact on one's estate during his lifetime as well as after death and on his survivors. Many of the laws are very complex and vary widely with the state of residence. Thus final plans, such as wills and trusts, require the professional assistance of a lawyer. However, the serviceman needs to know the basics of the law because they should be taken into consideration when he originates his plan, when he buys property, and when changes occur in his personal life. He needs to know the effects of income taxes, the limitations and advantages of certaintypes of ownership, and have some knowledge of laws that have an effect on the estate so that intelligent decisions can be made. Some of this knowledge is essential at an early age, often before much of an estate has been accumulated, to preclude paying the high costs of rearranging matters within the estate later in life. Here again, the application of these fundamentals is largely dependent on the personal family situation, the objectives of the individual, and on the size of the estate. This basic knowledge can save the serviceman the costs of establishing certain programs which he may not need. If the estate is small, for example, a trust can cause unnecessary expenses in drawing it up and

also unncecessary expenses for attorney's fees and taxation at the time of death /Harris, p. 19_/. The serviceman should know at about what point and under what conditions he needs such arrangements.

FEDERAL ESTATE TAXATION AND THE MARITAL DEDUCTION

Federal estate taxes apply if the adjusted gross estate is in excess of $60,000. The adjusted gross estate is the gross estate less debts, funeral costs, unpaid taxes, and administrative expenses. Federal estate taxes are computed on the amount left from the net estate after a $60,000 exemption. Because of the enactment of Federal tax laws in 1948 which were intended to equalize the tax positions of residents of community and noncommunity property law states, combined adjusted gross estates with the spouse of less than $120,000 may not be subject to federal estate taxes because of the marital deduction /Harris, p. 54_/. The marital deduction allows the widow or widower to inherit half of the spouse's adjusted gross estate tax free. This is in addition to the $60,000 exemption. Thus if the adjusted gross estate of one member of the marriage partnership is in excess of $60,000, tax savings may be realized through the prudent arrangement of the estate. If the estate of one member is $120,000 and the spouse also has an estate, the tax savings may be considerable. Since the marital deduction assumes importance when the adjusted gross estate of one member is in excess of $60,000, there is a definite need for the coordination

of the wills of both members if they desire to take full advantage of the marital deduction [Harris, p. 63]. The decision to use or not use the marital deduction can mean the difference of several tens of thousands of dollars in taxes in a $200,000 estate depending on how the assets are owned and the arrangement of the estate. The decision is largely dependent on the family situation and the objectives of the individuals concerned. It depends on the willingness to give the surviving spouse control, ownership, and the right to dispose of the estate however he pleases. The married couple must make a choice between two basic alternatives. The choice is generally whether one wants to turn over control of the estate to the surviving spouse thereby minimizing estate taxes, or if he wants to maintain control even after death ensuring the preservation of the estate at the expense of heavier taxes. There are, of course, subsets of these alternatives depending on the objectives of parties involved. In a fairly large estate the surviving spouse might not need control of the entire estate, and the objective might be to provide an income from the assets of the estate.

Example of the Marital Deduction

ASSETS		
Business	$100,000	(Husband owns)
Securities	50,000	(Husband owns)
Home	35,000	(Owned as tenants by the entirety)
Savings Account	10,000	(Jointly owned)
Life insurance	50,000	(Husband owns, wife is beneficiary)
Gross Estate	$245,000	

DEBTS AND EXPENSES	
Funeral costs	$10,000
Attorney's fees	5,000
Unpaid taxes	1,000
Administrative Exp.	1,000
Outstanding Loan	3,000
Total Debts & Expenses	$20,000

Gross Estate	$245,000		
Less Total Debts & Exp.	20,000		
Adjusted Gross Estate	$225,000		
Maximum Marital Deducation	112,500	(50%)	(Transmitted to Spouse Tax-Free)
Net Estate	112,500		
Less Exemption	60,000		
Taxable Estate	52,500		
Federal Estate Tax Payable		$7,525	

If the estate above had not provided for the maximum marital deduction (insurance did not qualify for the marital deduction because of being payable in installments, other assets were left in trust to pay income for life) the estate tax would be computed as follows:

Gross Estate	$245,000	
Less Debts & Expenses	20,000	
Net Estate	225,000	
Less Exemption	60,000	
Taxable Estate	165,000	
Federal Estate Tax Payable		$38,400

[Harris, p. 56]

> In the normal smaller estate, where the family relationship is good there is little question about the use of the marital deduction. The savings are just too good to resist. If your estate is $120,000 and your wife has no assets, the difference between using and not using the marital deduction is $9,340 in estate tax [Harris, p. 59].

USE OF THE MARITAL DEDUCTION WHEN BOTH HUSBAND AND WIFE HAVE ESTATES

It must be kept in mind that all interests do not qualify for the marital deduction. This is the reason why it is important to arrange the estate so that the maximum advantage

may be taken if it is to be used. It must also be noted that it is not always a maximum monetary advantage to use all of the marital deduction. The marital deduction does not eliminate estate taxes. It may reduce them somewhat because the last surviving spouse will also have the $60,000 exemption so that the remaining property will be taxed in a lower bracket. The primary advantage is that it delays a portion of the taxation so that the surviving spouse benefits from having a larger estate [Harris, p. 57].

In cases where both the husband and wife have approximately the same estates, it may not be advantageous to use the marital deduction at all. Where the estates are the same size the marital deduction will usually result in a larger combined tax so that here again, individuals are faced with a choice between two basic courses of action. It must be decided what the objectives are. The objective may be to transfer the maximum amount to the spouse, or it may be to preserve the estate so that the maximum amount of property from the combined estates is eventually transmitted to children or others. The maximum tax savings are usually realized by using only the portion of the marital deduction that is required to equalize the estates [Harris, p. 60].

Example of the Marital Deduction When Both Husband and Wife Have Estates

	Husband's Estate (He dies first)	Wife's Estate
Adjusted Gross Estate	$90,000	$30,000
Less Maximum Marital Ded. 50%	45,000	45,000
Net Estate	45,000	75,000
Less Exemption	60,000	60,000
Taxable Estate	0	15,000
Federal Estate Tax Payable	0	$ 1,050

$45,000 transferred to wife, $45,000 transferred to children.

If only $30,000 of the Marital Deduction had been used, there would have been no estate taxes on the combined estates.

Adjusted Gross Estate	$90,000	$30,000
Less Portion of Marital Ded.	30,000	30,000
Net Estate	60,000	60,000
Less Exemption	60,000	60,000
Taxable Estate	0	0
Federal Estate Tax Payable	0	0

$30,000 transferred to wife, $60,000 transferred to children.

(Examples assume that there are no drawdowns or additions to the estates.)

The arrangement to transfer the entire estate to the surviving spouse can be costly. Unnecessary taxes are incurred if the estate exceeds $60,000 and the entire amount is left to the spouse. On an estate of $80,000, $1,600 of additional payment in estate taxes on the combined estates is required. The arrangement to transfer the entire estate to the spouse wastes $4,800 on a $100,000 estate and $10,700 on a $125,000 estate because of the combined effect of estate taxes [Harris, p. 60]. Of course, it may not be desirable to transfer the excess to children; the surviving spouse may need the property.

The point is that certain devices may be used effectively in the $100,000 estate and may be more important though less spectacular than in the $500,000 estate. There may also be a problem of liquidity in the smaller estates. If the desire is to transmit the entire estate to the spouse or to preserve the combined estates paying out an income to the spouse from the estate, then some fairly high estate taxes may have to be paid. Without a strong cash position at that time, the surviving spouse might be required to sell some assets out of the estate, in order to retain the remainder.

In case of simultaneous deaths there are situations where portions of the estate would be taxed twice. If the marital deduction is desired a provision may be put into the will "presuming that spouse survives" which allows half to pass as the marital deduction should death occur simultaneously.

JOINT OWNERSHIP

Joint ownership offers no advantages in federal estate taxation, and it can cause the same property to be taxed twice [Harris, p. 9]. Joint bank accounts, securities in joint names, and a house jointly owned are all taxable. Likewise, securities and insurance owned by the husband and payable to the wife are also taxable [Harris, p. 4]. "Many prepare a will on the assumption that joint property will pass under it. If everything is held jointly the will has no effect at all [Harris, p. 47]." If the combined estates are between $60,000 and $120,000, joint ownership results in extra taxation.

If the husband died first with a joint estate of $120,000, no estate taxes would be payable with maximum use of the marital deduction and the standard $60,000 exemption. However, if the wife had $100,000 of the estate left at her death the Federal estate taxes would amount to $4,800. Taxes on a $120,000 estate can be eliminated entirely through separate ownership and trusts.

Another problem of joint ownership is that the entire assets are taxable in the estate of the one that dies first unless the survivor can prove ownership. The burden of proof of ownership is on the survivor. Thus, if the wife died first having never earned an income or having no inheritance, the husband might be required to pay taxes on a relatively small estate to which he has been the sole contributor. It is not enough to say that the wife never worked or that she never contributed to the estate. Definite proof of ownership is required /Harris, p. 47/.

It is often desirable to maintain joint ownership of some property. Owning the home, cars, and a bank account jointly can be an advantage because the property passes directly to the survivor without going through probate so that the delays and costs of administration are avoided. The costs of administering an ordinary uncomplicate estate in probate may range from 5-10% on the part of the estate which passes under the will for appraisal fees, executor's commissions, and counsel fees /Harris, p. 14/. Lifetime gifts, joint assets, living trusts, and insurance are not normally probated, thus these

costs are avoided. The advantages and disadvantages must be carefully weighed by the individual. Some states have peculiar laws regarding joint bank accounts, and some do not allow withdrawals until after the settlement of the estate. This is to prevent the amount from going unreported for tax purposes, and also because it might be considered as a gift.

PROPERTY WHICH DOES NOT PASS UNDER THE WILL

The family residence held jointly or by the entirety, joint bank accounts, accounts in the name of the husband in trust for the wife, securities in joint names, U. S. Savings Bonds held either jointly of payable on death to the wife, interests created by lifetime trusts, life insurance trusts, and life insurance payable to the wife are all types of property that are transferred to the spouse outside the will /_Harris, p. 61_/. All of these transfers qualify for the marital deduction with the exception of trusts and life insurance trusts which may qualify depending on the conditions of the transfer of the property. In general, trusts qualify for the marital deduction if the spouse is given control and ownership, and if the principle of the trust passes into the survivor's estates at the time of his death. It must be remembered that passing or transferring property outside the will does not prevent estate taxes, although certain properties can delay taxes. The danger here is in the form of ownership in that too much property may be qualified so that the estate

is inflated. The majority of the tax burden could come at the time least expected, whereas other arrangements can delay the burden until the death of the surviving spouse. The inflated estate can be avoided by several methods such as separate ownership.

EXCLUDING PROPERTY FROM THE ESTATE

Several kinds of property may be excluded altogether from the estate of the first of a married couple to die. It will be subject to taxation when the survivor dies, although the second estate could be diminished by drawdown or by making gifts. This is basically accomplished by transferring ownership of the property and by relinquishing all "incidents of ownership," and it is also a form of a gift [Harris, p. 86]. Thus life insurance and property in irrevocable trusts may be excluded from the estate, provided that all "incidents of ownership" are surrended. The test of an "incident of ownership" is whether any power of control over the proceeds or any substantial beneficial interest so as to shift economic benefit from yourself to the living was retained at the time of death [Harris, p. 86]. One may not alter, amend, revoke, or terminate enjoyment of the trust, or have the power to do so; otherwise the property will be taxable in the estate of the donor. With insurance the right to change the beneficiary either by yourself or with the consent of the beneficiary, the right to surrender or cancel the policy or to borrow on it, are all "incidents of ownership." As a result of the Revenue

Act of 1954 one may purchase as much insurance as he can afford for a policy on his life that is owned by another and the proceeds will not be taxable in his estate. Gift taxes would have to be paid on the amount of the premium payments to the extent that they exceed the gift tax annual exclusion and the lifetime gift tax exemption, but this allows a very large amount to be obtained. Proceeds from life insurance taken under several options also get a favorable treatment from income tax when the beneficiary is the spouse [Harris, p. 85]. The proceeds may be prorated over the number of years payments will be made in the "limited installment certain" or "fixed income" options. The life expectancy of the surviving spouse is used at the basis for computations in the "life income" option. Thus if the "life income" option was elected on a $50,000 policy payable to the spouse at the rate of $3,000 annually with a life expectancy of 21.7 years, there would be no income taxes on the $3,000 yearly income from the insurance. This is because the $50,000 divided by 21.7 equals $2,304 as the annual prorated amount. This $2,304 combined with the annual insurance exclusion of $1,000 is greater than the $3,000 income; therefore, no income taxes are payable on the income [Harris, p. 86].

Insurance is a workable tool within the structure of an estate. It can be arranged in many different ways in order to take advantage of the marital deduction or to pass outside or under the will. The amount of property that is passed to the spouse tax free may also be increased by coupling insurance

payable to a charity with the marital deduction. This may be accomplished by buying a large life insurance policy naming a charity as the irrevocable beneficiary, but retaining certain "incidents of ownership" such as the right to specify the settlement option so that the policy would be included in the gross estate. This would boost the gross estate thereby increasing the amount passed tax free to the spouse in the marital deduction. This method has some obvious disadvantages for the usual situation. Insurance is expensive, and the taxation on the estate of the surviving spouse would be higher. But in certain cases there may be no children, and then, if the individuals want to donate a large amount to a charity, the amount of estate preserved for the surviving spouse may be increased. This method is normally applicable only to relatively large estates with enough excess income to make premium payments.

	Estate of first to Die <u>with Donation</u> to Charity	Estate of first to Die <u>without Donation</u> to Charity
Assets		Assets
Business, Securities, Home, Etc.	$1,000,000	$1,000,000
Life Insurance payable to charity with "incident of ownership" retained.	500,000	0
Adjusted Gross Estate	1,500,000	1,000,000
Maximum Marital Deduction 50%	750,000	500,000
Net Estate Prior to Insurance	750,000	500,000
Less Insurance	500,000	0
Net Estate	250,000	500,000
Less Exemption	60,000	60,000
Taxable Estate	190,000	440,000
Federal Estate Tax Payable	$47,700	$126,500

[Newman, p. 230]

With the estate arranged in this manner there is an estate tax savings of $78,800. Nine Hundred Fifty-Two Thousand Three Hundred Dollars ($952,300) is transmitted to the surviving spouse in addition to $500,000 to charity in contrast to $873,500 transmitted to the surviving spouse where there is no donation.

Loans taken against an insurance policy can make a difference in the computation of estate taxes, because it is treated differently if one pledged his policy with a bank for a loan or if he borrows on the policy from the insurance company. If the loan is taken out with the insurance company the beneficiary will receive the difference between the face value of the policy and the amount of the loan balance. If the loan is with a bank the beneficiary receives the full amount of the policy, and the estate of the deceased is liable for the debt. The amounts would not change the net assets, however it will change the amounts received by the survivor. The amount could have a significant effect on the amount of estate taxes depending on the configuration of the estate, and it will effect the amount of the marital deduction.

The laws of the state must be ascertained in regard to insurance. They vary widely in the treatment of premium payments, naming of beneficiaries, and proceeds.

GIFTS AS A MEANS OF REDUCING THE TAXABLE ESTATE

The transfer of property without equal consideration in return constitutes a gift. Thus, a gift takes place which could be subject to taxation under gift tax laws when a trust

is created or when a debt is forgiven, when a wife draws money from a joint bank account which was established with the husband's money, when securities or a home is purchased with the funds of one member of the marriage partnership and joint title is taken, or when the husband pays premiums on life insurance policies owned by the wife /_Harris, p. 38_7.

There are two basic types of gifts. Lifetime or "inter vivos" gifts refer to gifts made during one's lifetime. "Causa mortis" gifts are gifts that only take effect at death and may be revoked during the lifetime of the donor. Most estate planning concerns the "lifetime" or "inter vivos" gifts /_Harris, p. 38_7. There are many valid reasons, nontax as well as tax, for making lifetime gifts. Nontax reasons include the avoidance of delays and the expense of probate, removal of the subject from public scrutiny, creating financial maturity and independence among family members, and providing against possible incompentency among other important reasons. Tax reasons are the possible savings in income taxes, gift taxes, and estate taxes /_Harris, p. 39_7.

Each year one may give $3,000 tax free to as many recipients as he desires and there is in addition a lifetime exemption of $30,000 which may be used all at one time or spread over the years as desired. The marital deduction applies to gift as well as estate taxes so that only half of any gifts to the spouse are subject to tax. Because of the split gift provision, the members of the marriage partnership may give away $60,000 under the lifetime exemption plus $6,000 per recipient per

year without paying any gift tax. Thus a husband and wife could give their three children $78,000 in the first year and a total of $18,000 annually to them tax free in each successive year. Gift taxes are only about 3/4 of the estate tax at any particular level. If an estate were in an estate tax bracket of 27.6%, a gift of $100,000 would remove that property from the estate to a gift tax bracket of 13½%. Another advantage is that all states have some form of "death" tax, while only a few have gift taxes [Harris, p. 40]. Thus if one had a very large estate, more of it could be retained by paying gift taxes even if the amounts of gifts exceeded the lifetime exemption and annual exclusions than by paying estate taxes on the same amount. In cases where the original planning may have been lacking, a large amount of insurance could be transferred out of the estate to whomever desired. The gift of insurance would not be valued on the face amount of the policy, but on its value at the time of transfer [Harris, p. 35]. Gifts made within three years of death are presumptively in "contemplation of death" and may be tested to determine if the gift should go back to the estate for estate tax purposes. All gifts made more than three years prior to death may not be attacked on the grounds of "contemplation of death [Harris, p. 50].

GIFTS TO MINORS

Lifetime gifts can mean a tremendous tax savings in the larger estates, but they may be used just as effectively in smaller estates. The amounts of tax savings involved may not

be as large in absolute terms, but it may be even more significant because of the ratio of a few thousand dollars in savings to the size of the estate.

Since the Revenue Code of 1954 parents can make gifts to their minor children or grandchildren in trusts. The parent is entitled to the annual $3,000 gift tax exclusion as long as the property and its income is used for the benefit of the child until age 21 at which time the child assumes control and ownership [Harris, p. 44]. This has very attractive features for creating educational trusts for children in that fairly large funds may be accumulated for children while offering income tax and estate tax savings, and possibly gift tax advantages to the donors. It may also present problems because if a substantial sum is built up when the minor reaches 21, it may not be desirable to turn it over to him. As with other gifts the retention of control over such a fund will cause it to revert to the estate of the donor for estate taxes; and if the income from the trust is used in behalf of the parent, it will be included in his earnings for income tax purposes. For these reasons it is generally advisable that someone outside the family be appointed trustee of the fund. There are various methods of contributing to the trust so that the annual exclusion is not exceeded [Harris, p. 45].

Gifts of money, securities, and insurance may also be given under the "Uniform Gifts to Minors Act" which provides for the reservation of management powers by the parent or an

adult member of the minor's family. The annual gift tax exclusion still applies, but the funds would revert to the estate of the donor if the donor is custodian and dies before the minor reaches 21. As with gifts in trust to minors, any of the income used to satisfy a legal obligation of the donor would be taxed as income [Harris, p. 45]. There are also variations in state laws concerning gifts under the "Uniform Gifts to Minors Act." This type of gift offers the same advantages as gifts in trust to minors, and also allows personal management.

IMPORTANCE OF WILLS AND OTHER DOCUMENTS

Individuals may draw their own wills, but it is normally not advisable to do so. The laws of the state vary widely in the requirements for wills and professional legal advice should be sought in the drawing of the will in order that one's desires are carried out. An individual may have all the right motives and intentions, but he could cause great hardship to befall his survivors just for the lack of legal terminology. The individual needs enough knowledge to make intelligent decisions about his plan for life, but he should not attempt to draw the instrument that will execute his plan. A result could be that those desired to benefit could be left without a share in the estate, children could be disinherited merely by not mentioning by name, and countless other problems could occur. Another result could be that the will was invalid; and then the estate would be handled just as if there were no will at all.

In dying without a will the estate is distributed in accordance with the laws of the state. This could cause the spouse to be denied access to the part of the estate that would go to the children. The spouse might be required to get a court order each time he wanted to withdraw money for the children's use and would also be required to account for all the amounts. In cases where there are no children most states divide up the estates between the surviving spouse and the next of kin of the decreased; thus part of the estate could conceivably go to those whom the survivor has never seen. If a business is owned it might have to be liquidated because the spouse was not authorized to continue the business. Securities and properties held might have to be liquidated for inclusion in the estate. The decision as to whom should manage and administer the estate may be at the discretion of another, and the full benefit of the marital deduction may be denied. There are a host of other reasons why the individual should take ample precautions by providing a will, other than monetary. In the case of both parents dying at once, perhaps in a car accident, in certain states the children become wards of the state rather than being cared for as the parents might have desired.

There should also be a means of providing information to executors or executrixes about the location of important papers, such as deeds, wills, securities, records, bank statements, insurance policies, and other documents pertaining to the estate. It is perhaps of even greater importance to

furnish information as to the existence of these papers as well as the location for obvious reasons. In all too many cases an excessive amount of time and money is expended searching for the unknown. All these important papers should be updated periodically, and on the occasion of changes in the estate or in the family.

APPENDIX A

Senator Hart. The committee will be in order.

Permit me a brief opening statement. More than 300,000 times a day, all year long, American consumers pay a bill without having more than a somewhat vague idea of what they are buying.

If this were the result of flimflam, enforcement agencies would have been all over the sellers years ago. But this is not intentional flimflam--it is as the man in "Fiddler on the Roof" explained away so many things--"tradition."

These 140 million consumers, at an outlay of about $23 billion a year, are buying life insurance policies.

Many years ago, when life insurance was born a consumer knew what his annual premium bought; a guarantee that on his death his heirs would receive x amount of money. This money generally was to compensate heirs for the loss of income due to the breadwinner's death.

As the years went on, insurance companies devised the level-premium method, which added a savings element to the insurance or death protection. The companies thought the idea would have consumer appeal, and would protect against the companies ending up with only the worst risks. And the facts seem to suggest the companies were right.

Of the total 20 million new ordinary and industrial life policies bought in 1971, less than 1 in 10 was the old-fashioned term protection.

But while the policies became a package of savings and protection, the premiums stayed a single unit. Thus, the vast majority of consumers today are putting a part into savings, and a part toward death protection when they deposit that premium. But no one is telling them how much goes into each category.

Obviously, as the convening of these hearings shows, I have the feeling that it is time that perhaps someone did. And this is a philosophy shared apparently by a number of others that we will hear during this opening set of hearings.

There is an antitrust concern over the way the life insurance market operates today. In our system, the consumer is supposed to reward the good performers, and encourage the poor to do better. He does this by his purchasing decisions.

This is what competition is all about. But pity the poor consumer attempting to do his job in the life insurance market.

Today, 1,805 companies offer so many different life insurance policies that no one has been able to count them all. One student found that 185 companies offered 21 different varieties of just term insurance.

This is supposedly the simple kind of policy to buy.

The situation gets even more confusing when a consumer is shopping for a savings type policy.

If the consumer cannot perform his function, then we can be assured that the marketplace will be filled with inefficiency and overcharging.

But there is a deep social concern in all of this, too: the impact on the ultimate consumer, usually widows and orphans.

Not only as a group, but individually, consumers spend an impressive amount of money for life insurance over the years.

One survey showed that of insurance-buying families in the income bracket of $7,500 to $15,000 a year, 41 percent were paying from $200 to $499 yearly, and 8 percent were paying from $500 to $999 a year.

Assuming a new 25-year old father in that 41 percent took out a straight life policy the day his baby was born and kept it until his own death at 65, his total premium outlay would be $8,000 to $20,000.

I am sure many of us would agree that that could be money very well spent. For--as evidenced by the fact that about two out of every three Americans have life insurance--most of us think it is responsible to provide for those we leave behind.

But the fact is that--despite the impressive outlays--the average family gets little money when the breadwinner dies.

The average face value of a group life policy is $7,130. For individual ordinary life, it is $6,450, and for an industrial life policy it is $520.

About two-thirds of the new ordinary life policies on adults written in 1971 were bought by those in the under $10,000 income bracket, about the average income for an American family. A recent life insurance study shows that

52 percent of the widows surveyed received less than $5,000 from their husbands' group and individual ordinary life insurance.

In a country where it costs about $50,000 to raise a child to the age of 18, it would suggest that the average family is grossly underinsured.

Now, this subcommittee is interested in finding out if accurate, clear, and meaningful information in the hands of consumers would improve this situation.

We are concerned, also, naturally, about restricitions on the competition which come from State laws and regulations, and perhaps from industry activities.

And it is for these reasons that we are gathered here today, and the days ahead....

I want to commend the chairman for initiating and sponsoring this inquiry into the life insurance business. It is a very large, massive program in America, very vital, and very influential in many, many ways. And it is considered in the world to be one of the better, if not the best, insurance systems that we have that is known to advanced or improved nations.

In these hearings, however, I would not be prepared to say that all of the evidence will be good, because I have read some of the statements, and I don't agree with many of them. And I don't think they will bear the glare of such cross-examination as we expect to make from time to time with the idea of reaching a clear, enlightening informational basis on which to form judgments in terms of either legislating or not legislating as a National Government.

All of us know that since the inception of insurance, we have had regulation of insurance by State departments, and when the Supreme Court reversed by judicial decision, that jurisdiction, and said it's also business in a sense of being interstate commerce, and, therefore, within the jurisdiction of the Federal Government, Congress, 25 years ago, promptly responded by saying, "As long as the States will regulate insurance, the Federal Government will stay out of that field." And that is the national policy today.

So that for a hundred years we had had this policy, and it has a good basis, it has a firm basis that has not been dispelled by the passage of time.

In fact, the province of the Federal Government has widened. There are even more salutary and sound rules for retaining State regulation in this field rather then going into Federal legislation.

But the big part of the hearings, I think one of the most significant things will be that we will be able, under the testimony when it is all in--not these first 2 or 3 days but when it is all in--the overview will show exactly what life insurance means, how it really functions, where the frailties are.

The frailties, I do believe, the record will show in due time, will not be so much in the insurance industry as perhaps with the watchfulness, the alertness, and the capability of the citizenry to understand what it is buying.

There are very few contracts entered into that are lifetime in character. Life insurance happens to be one of those. So that when a 5-year old child is insured, or a 20-year old man or woman is insured, that means anywhere from 50 to 75 years of contractual relationship, intricate, complex, heavily regulated by statute and by regulation of the insurance departments and, therefore, difficult to understand.

And so that when we encounter areas in which there are, perhaps what we would call "inadequacies," we must assess those inadequacies and find out where is the trouble, and what can we do to help, and what should we not do that might possibly be detrimental to the interest of the consumer by way of fastening additional responsibilities or burdens without corresponding benefits coming from them....

"Statement of Ralph Nader."

These hearings, which you have scheduled, are the first comprehensive investigations into the life insurance industry in the history of the United States Congress. It would therefore not be excessive to regard your Subcommittee's effort as one of historic proportions. This is the case both with regard to its resultant impact on this gigantic aggregation of capital and the millions of policyholders and beneficiaries whose reliance on the industry, in return for ample payments, has not been reciprocated with the trust that is its legal responsibility. In this period of disclosure of consumer abuses, from automobiles to drugs to food to loan transactions, few industries averted the scrutiny of Congressional committees such as yours. Partly because of historical accident awarding jurisdiction to the states and partly because of the focus of government attention on auto insurance reform, the life insurance industry is, perhaps, the last giant industry to come under the legislative microscope. Its contrived complexity, secrecy and public relations have fulfilled a strongly supplementary camouflage function. Hidden behind this camouflage, are two principal levers of maximizing life insurance

company profit or surplus--deception, and ironically, gross waste. Neither redounds in any way to the consumer's benefit. For almost seventy years the life insurance industry has been a smug sacred cow feeding the public a steady line of sacred bull.

The scope of the inquiry before this Subcommittee can be encouraged by the size of the population concerned and the magnitude of the monetary stakes. About 140 million Americans are covered by some form of life insurance sold by this $235 billion asset industry. Total life insurance in force at the end of 1971 was $1.6 trillion. There is now over $789 billion worth of ordinary life insurance in force and the industry's five top companies (Prudential, Metropolitan, Equitable, New York Life and John Hancock) share over 41% of this total and control over 44% of the assets of the entire 1805 company industry. According to a 1961 National Industrial Conference Board study more than 5½% of total consumer expenditures went to life insurance companies. Last year, the industry reported $23 billion in premium receipts. An additional $13 billion a year is now going to these same companies in the form of health insurance premiums. The lion's share of these premiums go to a handful of companies.

No other concentrated group of corporations, except the auto manufacturers, claim a larger share of the consumer dollar. Unlike the auto companies, however, there is likely to be a greater <u>potential</u> of divergent views or dissent accessible to this Subcommittee, particularly if the united-front-minded trade associations are advised to avoid undue pressuring against the coming forward of any smaller companies or employees who have such divergent facts and judgments. There are also some companies whose prices for equal benefits are considerably lower than the giants in the industry--a phenomenon which provides important data about the uses of secrecy and the need of disclosure of comparable value to the consumer, as Professor Joseph Belth has demonstrated in his new book.

In a superlative of duplicative atrophy, the entire life industry is "regulated" by 50 different state insurance departments plus the District of Columbia and Puerto Rico. As a practical matter, it is exempt from antitrust regulation and from other federal consumer laws. Remarkably, there has <u>never</u> been a systematic investigation of competition and concentration in this industry by any federal agency or by Congress or by the academic community.[1] It would be accurate to say that the states have contributed very little to this subject as well, except for some materials in the Armstrong Committee Report (of the New York State legislature) in 1905. These hearings will have to pioneer this enormous task...

AN OVERVIEW

Mr. Chairman here are some of the findings of our present testimony.

2. Through deceptions and inadequate information, the life insurance industry dupes husbands into shortchanging their wives and children by buying too much of the wrong kind of insurance (or too little of the right kind) at excessive prices.

3. Because there is little or no meaningful and communicated price competition, the high expenses of the life insurance industry--virtually all borne by the consumer--are a national disgrace.

4. The "quiet" concentration of economic power by this industry has been substantially ignored by Congress, by the academic community and by citizens who are mistakenly asked to believe that competition over agents and empty advertisements is value competition...

6. Criticism of the industry is responded to with collateral irrelevance, semantic nullities, or private attempts to remove academic critics from their teaching positions. Instead of rational argument, company or trade association spokesmen use pompous pontification or a kind of patronizing insurance patriotism with roots deep in the industry's chauvinistic past.

1. FAILURE TO PROTECT ITS "ULTIMATE CONSUMER": THE WIDOWS' STUDY

The Institute of Life Insurance--the public relations arm of almost the entire industry--maintains that "the main reason what a man buys life insurance is to protect his family from financial hardship when he dies." Whether or not companies sell life insurance for other purposes such as to provide a savings or investment medium or to make a profit, the primary measure of their performance is the extent to which the financial needs of widows and children are being met. The real consumers of life insurance are those who survive after the premature death of the breadwinner. The industry's own analysis of the benefits received by survivors demonstrates that it has failed miserably.

"The Widows Study" conducted by the Life Underwriter Training Council and the Life Insurance Agency Management Association and published in 1970--but never widely circulated even within the industry--provides shocking and tragic evidence of this failure. Fifty-two percent of a representative sample of all widows received less than $5,000 in benefits even though 92% were covered by some form of life insurance.

The second phase of the Widows Study dealth with the situation of widows during and at the end of a two year period of widowhood. In the words of the authors..."[T]he fact that

a wife faces a 50-50 chance of undergoing a decline in living standards if her husband dies prematurely--and a 1 in 5 chance of undergoing a serious decline--should dispel any complacency about the adequacy of existing life insurance benefits." Without realizing the full implications of their findings, the authors heavily underscored the fact that "the life insurance industry, operating through its sales representatives had had the opportunity to reach these families before their husbands deaths." Indeed they had, since 92% carried insurance! The authors went on to conclude, "Judged by any standards, the amounts of life insurance received by the widows were low." (Emphasis added). As the widow of an accountant said when asked what would make it easier for other widows, "Nothing but money. If we only had a little more to live on things would be a lot easier."

Despite the widespread reliance on life insurance of all kinds for widow protection, wives generally are simply not well protected against the risk of the premature death of their husbands. Husbands do buy life insurance but they buy too much of the wrong kind. With limited funds available, they are too often misled into putting them all into low benefit cash value policies at inflated prices.

2. THE UNKNOWN CONSUMER: THE WRONG KIND OF INSURANCE

Buyers are told in the typical sales presentation that if they buy term insurance, they'll have nothing left when the policy expires. The pitch is to the husband's ego rather than the wife and children's needs. The husband is exhorted bo buy "living values" rather than death protection. If he buys a "cash value" policy he is told he can get most or all of the money he pays in premiums back through increasing cash values and so-called "dividends" which are in fact refunds of overcharge...

First, the face amounts of cash value policies are substatially smaller given the same premium dollar. (As one gets older, term premiums do increase but they are low when the wife's needs for insurance against the premature death of her husband are highest). Buyers with limited funds available for life insurance--that is most buyers) are sacrificing necessary protection in order to fulfill the company's promise that you will "get something back."

Second, because of the abysmal state of price disclosure in the industry--as Professor Belth and others have demonstrated--the purchaser of a cash value policy really doesn't know what he or she is getting and how much it costs. Part of what is "bought" is a"savings account," another part is pure insurance. The consumer isn't given a breakdown of the premium for this package of protection and savings.

Third, the consumer who buys a "participating" policy--one for which he is promised something called a "dividend"--is not told that the dividends are "nothing more than a refund of a deliberate overcharge and should not be confused with ordinary dividends payable to corporate stockholders," according to Professor Dan McGill of the Wharton School of Finance. He is typically told that this overcharge is tax free. He is not told that they are tax free because they are merely refunds. In 1911, insurance companies sought a favorable ruling through the Treasury Department on the treatment of dividend payments for certain tax purposes. To get a favorable ruling they had to show that dividends were in fact an overcharge and not "dividends" in the commercial sense. Accertain tax purposes. To get a favorable ruling they had to show that dividends to disregard all their public and promotional statements about dividends on the grounds that "commercial necessity [i.e., the need to make sales] had resulted in making misrepresentations of facts as to dividends to their prospective purchasers." We rarely see such candor today. Based on life insurance promotion literature, most buyers of insurance do not have the benefit of the truth about "dividends."

The traditional misuse of the term "dividend" is only one example of the unnecessary semantic traps this industry has laid for the consumer. Here is another. Cash value insurance is called "permanent" insurance and term insurance is called "temporary" in sales presentations. The fact is that only 1/3 of the "permanent" insurance sold today will still be in force in twenty years (according to recent industry submissions to the SEC). And the most commonly sold term policy is renewable every 5 years and can be converted later in life to cash value insurance which could be carried to age 100 like so-called "permanent."

Fourth, the typical first year premium on cash value policy may be a trap for the unwary. Most selling costs, including advertising and commissions are charged against first year premiums. In the early years cash values are low and dividend accumulation is minimal. So if you drop your policy in the first year you can't reap the benefits of any cash value you've been told will build up, and, in fact, you never get any of that first year premium back. An astonishingly high percentage of cash value policies are in fact voluntarily terminated or "lapse" in the first two years.

In the recent Variable Life Insurance Proceeding before the SEC, the Equitable Life Assurance Society, number three in the industry, revealed that 25% of its ordinary life policies (sold to 25 and 35 year old customers) lapsed in the first year, another 10% in the second year. The first year lapse rates for New York Life and Aetna were 19% and 15% respectively.

Lapse data have been traditionally highly secret. No wonder that the Life Insurance Fact Book of the Institute of Life Insurance, the most widely disseminated collection of industry statistics does not publish lapse or termination rates for policies in force less than two years. The question: Why? our Subcommittee may usefully ask the Institute of Life Insurance. The Fact Book does not report lapse figures for 2 year old and younger policies. It asserts only that after the critical first two years, about 4% of the policies in force lapse each year--a figure which deserves skepticism and may be under-reported given the individual company figures just noted. The sharp dropoff requires greater substantiation than the Fact Book wishes to provide.

Mr. Chairman, let me reiterate: cash value policies--that is the type of policies that represent 72% of the $731 billion ordinary life insurance in force in 1970--are a consumer fraud not because they are inherently valueless but because purchasers are denied systematic and useful information about alternative plans available to protect their wives and children, and the price for that protection, while they are urged with all the collossal mind-bending skills at the company's and agent's disposal that Plan X is the best. It is very often the best for the agent and the company but not for the customer. In short, consumer ignorance, not the consumer, is what helps make possible the lack of selective feedback and the ease of manipulation by companies skilled in obfuscation larded with silken reminders about the potential policyholder's obligations to loved ones.

3. EXORBITANT HIDDEN EXPENSE

The cost of distribution system for the life insurance product in the context of a market with virtually no price competition is a national disgrace. Pick up any of a number of publications by and for the industry and you'll find frequent reference to 1) the high costs of selling and 2) the failure to find, keep and adequately compensate life agents.

Gordon Crosby, Chairman of the Board of United States Life, told the 1970 meeting of the Life Insurance Institute, "The basic patterns of the [life insurance distribution] system we use today came out of the Civil War days--and we've let our distribution costs get out of hand." The National Underwriter's Life and Health Edition, a leading industry journal, commented on a study done for the industry by the management firm of Daniel Yankelovich: "What Mr. Yankelovich was saying was what has been said many times before and since--and mostly by individuals from within the industry. That is, that distribution costs are disproportionate to the price of the product delivered when compared to distribution costs of other industries."

We have attached a table (Table B) which compares overall expenses for sales or ordinary life insurance with those for group life of eight leading companies and another table (Table C) which expresses expenses as a percentage of premiums for these same companies. Out of about $7 billion paid in premiums to these eight companies for ordinary life insurance individually sold, almost $2 billion went to expenses. Most people understand that it is less expensive to sell group insurance, but few realize how much higher are ordinary life expenses. On the average 27% of every premium dollar went to expenses compared with 5.9% for group insurance. And this grossly understates the expenses typically loaded onto the first year premium (55% agents commissions alone is typical for individually sold cash value insurance for those companies doing business in New York; many companies not in New York pay 100% or more for certain special policies).

Not only consumers, but life insurance agents also are victimized by the systematized ignorance engendered by the industry. Michael P. Walsh, Director of Marketing, Home Life of New York, told the 1970 I.L.I. meeting that only 11% of men recruited and selected are still in the life insurance business at the end of five years, compared to 40% to 50% of the sales positions in other industries. One life broker estimated for the National Underwriter that the industry spends $1 billion a year on agent turnover, has been doing it for years, and things are getting worse. The Subcommittee could initiate inquiries to find out how the industry absorbs such "losses" and transfers them to consumers, how agents are recruited, and to what extent does the rapid turnover demonstrate the advisability of different distribution systems that are more efficient.

Submitted for inclusion in the record, with your permission, is a collection of advertisements for agents gleaned from insurance trade publications over the last few years. Many are merely designed to create a good image of the company. But many others are the sort of brassy testimonials usually associated with get-rich-quick schemes. Aside from the resources thrown into this effort, it seems that some companies are so used to deception that they use it to recruit agents as well as sell insurance. Obviously, the real competition among companies is for agents. This may explain in part the apparent anomaly of high turnover and low average income for agents. These ads and other promotional schemes generate expectations of high earnings that are never fulfilled.

Mr. Chairman, there is something seriously wrong when an industry, whose top five companies control 44% of its $235 billion assets, delivers its products at a self-admitted exhorbitant cost, squeezes the earnings of an insecure "migrant" sales force, massively misinforms or underinforms the public about the very nature and price of its primary product

and yet continues to grow and increase its profit or surplus at a rapid rate. Producer sovereignty over regulation and in place of consumer sovereignty makes deception and concentration pay rich dividends but not to the policyholders.

4. QUIET CONCENTRATION

...

The 11 leading companies by premium volume are all mutual companies. Since giant mutual companies have no third party, stockholder interests to satisfy, and since the whole concept of the mutual form of organization is to bring the highest benefits at the lowest cost to policyowners, these companies should be in the forefront of efforts to produce meaningful disclosure. They should operate with the lowest costs, "profits" should be returned to policy holders in the form of higher dividends and lower premiums, and management should strive to increase the voice of policyholders in making important decisions about company policy. There is absolutely no evidence, however, that these mutual companies perform any better than their shareholder-owned counterparts. They are characterized by insulated management cliques, policyholder apathy or ignorance (not only about the products they buy but about the rights which they have as "owners" of the company), and bloated selling expenses. More specifically, they have been building up "surplus surpluses" and investing policyholder earnings in business lines far outside the life insurance area. Potentially the most accountable, they are in fact the least accountable of all our economic giants.....

5. PROFITS, SURPLUSES, AND THE SEC

The profitability of life insurance companies is nearly as inscrutable as the typical cash value life insurance policy--and the companies, especially the giant mutuals seem to like it that way. A perusal of the industry's Life Insurance Fact Book will reveal virtually no reference to profits or, as the mutuals call profits, "additions to surplus". In a series of maneuvers in late 1971, barely noticed beyond financial circles, the mutuals and some of their stock company allies convinced the SEC to postpone the adoption of a new audit guide for insurance companies. The guide, proposed by the American Institute of Certified Public Accountants (AICPA), would have required companies to show as earnings money currently flowing into reserves or being counted as costs. Under present rules, selling costs are written off the first year, since they are so high--some companies pay 100% of the first years premium as commissions--a company writing a lot of new business may actually show a loss (as did both Equitable and New York Life in 1971, the 4th and 5th largest companies respectively).

The AICPA proposals would have made one other serious change: To calculate the amount that ought to be set aside in reserves. Companies use formulas based in part on the earnings they expect from investing those reserves and on mortality tables. Currently, they use a 10 year old mortality table and an estimate return on investment of $3\frac{1}{2}\%$. This means they are putting substantially more in reserves for every premium dollar they receive than they would were they to use current mortality tables and 5% to 6% interest rates. These dollars would otherwise show up as higher earnings. Higher earnings in turn might mean more pressure from policy holders for lower premiums and, perhaps more important a change in their income tax basis.[3]....

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